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## India's international investment agreements and India's regulatory power as a host nation

Ranjan, Prabhash

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INDIA'S INTERNATIONAL INVESTMENT  
AGREEMENTS AND INDIA'S REGULATORY  
POWER AS A HOST NATION

Name - PRABHASH RANJAN

THESIS SUBMITTED FOR PHD TO KING'S  
COLLEGE LONDON

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## ABSTRACT

There has been an exponential growth in International Investment Agreements (IIAs), signed by countries to protect foreign investments, in last two decades. These agreements provide broad standards of treatment and give private investors the right to challenge allegedly treaty-inconsistent regulatory actions of sovereign countries at international arbitration. Over the last decade or so, such investor-state disputes have increased manifold where all sorts of regulatory actions, like urban policy; health policy; monetary measures; taxation, property rules, environmental policy, have been challenged by private investors. These developments have not only brought the investor-state dispute settlement system under the scanner but have also made it imperative to critically review the substantive law the investor-state tribunals apply *i.e.* the IIAs. In this light, this thesis will critically analyse Indian IIAs, which have not been subjected to detailed research yet, despite India's gigantic IIA programme and India's increasing integration with the global economy. This thesis will analyse the provisions on fair and equitable treatment; expropriation; monetary transfer; and non precluded measures (NPM) in 73 Indian IIAs from the perspective of India's regulatory power as a host nation. The thesis hypothesises that the present formulations of these four provisions, in Indian IIAs, are capable of being interpreted in a manner that gives precedence to investment protection over India's regulatory power to adopt policies and measures directed at achieving legitimate policy objectives. Hence, the thesis concludes that these provisions in Indian IIAs should be reformulated in a manner that balances investment protection with India's regulatory power.

## CHAPTER 1

### IIAS AND REGULATORY POWER: AN INTRODUCTION

There has been a steady increase in the number of International Investment Agreements (IIAs). The number of IIAs has increased from 500 in 1990 to 3116<sup>1</sup> by the end of 2010.<sup>2</sup> In 2010 alone, 54 IIAs were signed, with 20 IIAs being signed between developing countries.<sup>3</sup> This increase in the number of IIAs has been followed by an increase in the number of disputes between foreign investors and host states. The number of known investor-state treaty disputes has increased from little more than 50 in 1996 to 450 by the end of 2011.<sup>4</sup> This has led to a global debate on the interests of foreign investors protected by the IIA, on the one hand, and regulatory power of the host state, on the other. This introductory chapter is an attempt to introduce this global debate as the backdrop against which the research on Indian IIAs has been carried out. The chapter introduces IIAs (Section 1.1) and provides a brief discussion on the meaning of regulatory power (Section 1.2). This is followed by a discussion on the emerging global debate on IIAs and host country's regulatory power (Section 1.3). After this, the chapter introduces the debate on Indian IIAs and India's regulatory power in light of the emerging global debate and provides the outline of the thesis (Section 1.4). Section 1.5 provides the methodology.

#### *1.1 PROLOUGE*

IIAs<sup>5</sup> are treaties signed at the bilateral, regional or multilateral level by two or more countries to protect investments made by investors of both the countries.<sup>6</sup> IIAs protect investments by imposing conditions on the regulatory behaviour of the host state and thus,

---

<sup>1</sup> The figure of 3116 IIAs includes 2807 Bilateral Investment Treaties and 309 other IIAs. This figure does not include Double Taxation Avoidance Agreements (DTAA).

<sup>2</sup> World Investment Report (2011)

<sup>3</sup> Id.

<sup>4</sup> UNCTAD (2012).

<sup>5</sup> IIAs, used as a generic term in this thesis, includes Bilateral Investment Treaties (BITs), Regional Investment Treaties (RITs) and investment chapters in Free Trade Agreements (FTAs) and in Comprehensive Economic Cooperation Agreements (CECAs). In India, IIAs are typically referred to as 'Bilateral Investment Promotion Agreements' (BIPA).

<sup>6</sup> Salacuse (1990), 503.

prevent undue interference with the rights of the foreign investor.<sup>7</sup> These conditions include restricting the host state from expropriating investments, barring for public interest with adequate compensation; imposing restrictions on host states to discriminate against foreign investment, barring certain circumstances given in the IIA; allowing for repatriation of profits subject to conditions agreed to between the two countries; and most importantly allowing individual investors to bring cases against host states if the latter's sovereign regulatory measures are not consistent with the IIA<sup>8</sup> to be monetarily compensated.<sup>9</sup> This is known as the investor-state dispute settlement system. In this thesis, the dispute settlement system along with the network of IIAs is referred as investment treaty arbitration (ITA).

There are several explanations given for the increase in number of IIAs, which can be broadly divided into perspectives of capital importing and capital exporting countries.<sup>10</sup> From the perspective of capital importing countries, it is argued that countries enter into IIAs to attract foreign investment.<sup>11</sup> One of the powerful voices in this regard is that of Andrew Guzman. He has argued that least developed countries (LDCs) entered into IIAs to overcome a 'dynamic inconsistency problem'<sup>12</sup> for self economic interests such as attracting foreign investment.<sup>13</sup> Other scholars have also argued that capital importing countries look at IIAs as

---

<sup>7</sup> In this regard it has been said that IIAs essentially focus on the '*rights of the investor and the obligations of the host state, rather than the obligations of the capital-exporting state, or indeed the obligations of the investor*' – Qureshi and Ziegler (2011), 499.

<sup>8</sup> For a general discussion on IIAs see Dolzer and Stevens, (1995); Sornarajah (2004), 204–314; McLachlan, Shore and Weiniger, (2007); Lowenfeld (2008), 467–591; Dolzer and Schreuer (2008); Muchlinski, Ortino and Schreuer (eds) (2008); Newcombe and Paradell (2009), 1-73; Muchlinski (2007); Subedi (2008); Salacuse (2010); Vandevelde (2010).

<sup>9</sup> Sykes (2005), which emphasises on the significance of private right of action for money damages in international investment law. It has been argued that investor-state dispute resolution became necessary because of the disadvantages that the investor faced in domestic courts of the host country and due to the weaknesses of the diplomatic system of protection – Choi (2007), 734-736.

<sup>10</sup> The distinction between capital exporting and capital importing countries is increasingly getting blurred due to the emergence of many countries that are both capital importers and exporters.

<sup>11</sup> This is clearly recognized as one of the key objectives of the Indian IIA programme, discussed later. Countries endeavour to attract foreign investment so as to fill the gap between resources mobilised and the resources needed to achieve growth and development targets - Todaro and Smith (2000), 711, Perkins *et al*, 526-533. Foreign investment plays an important role in complementing developmental processes at the national level by enhancing export competitiveness - WIR (1999), 234-244; creating employment opportunities and providing opportunities to local labour to develop new skills - UNCTAD (1999), Rajan, (2004), 12. It has also been argued that Foreign Direct Investment (FDI) in the form of green field investment (which is a net-addition to the capital stock of the host country) is beneficial to the host country in comparison to FDI in the form of acquisition (where there is no addition to the host country's capital stock) - Singh (2005). On the other hand, it is also argued that in certain situations foreign investment may adversely affect the country's economy by lowering domestic savings and investment by reducing competition and crowding out domestic investment - WIR (1999), 171-172; Ghose (2011).

<sup>12</sup> This means a situation '*when a preferred course of action, once undertaken, cannot be adhered to without the establishment of some commitment mechanism*' – See Guzman (2009), 78.

<sup>13</sup> Id; Guzman (1998).

admission tickets to foreign investments<sup>14</sup> and limit their regulatory power by entering into an IIA to reduce investor insecurity in exchange for increased foreign investment inflows.<sup>15</sup> Some scholars are critical of Guzman's mono-causal view arguing that LDCs enter into IIAs not just to overcome the 'dynamic inconsistency problem' but for a host of other economic and political reasons.<sup>16</sup> However, a recent empirical study shows that it is largely correct that developing countries have entered into IIAs hoping to attract more foreign investment.<sup>17</sup>

This leads to the question - do IIAs result in more investment flows? The empirical evidence and the academic debate on the effect of IIAs on foreign investment are divided and thus inconclusive.<sup>18</sup> There are studies that argue for a positive relationship between IIAs and investment inflows. For instance, Neumayer and Spees have analysed the data of 119 countries from 1970 to 2001 to argue for a positive relationship between IIAs and Foreign Direct Investment (FDI).<sup>19</sup> Another study argues that stricter IIAs increase FDI whereas less strict IIAs have no effect.<sup>20</sup> It has also been argued that although there is some positive effect of IIAs on foreign investment flows, these treaties are at best complements and not substitutes for good institutional quality and local property rights in the host state – factors which have a more direct influence on foreign investment.<sup>21</sup>

On the one hand, IIAs could be an important tool to attract foreign investment because by signing an IIA the host country signals congenial investment environment and offers treaty based protection and thus enhanced security for investment.<sup>22</sup> This enhanced security does play a role in boosting investor confidence to make investments.<sup>23</sup> However, on the other hand, arguably, signing IIAs alone do not ensure greater foreign investment inflows because

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<sup>14</sup> Dolzer and Schreuer (2008), 9.

<sup>15</sup> Id. Also see Salacuse and Sullivan (2005), 71; Dolzer and Schreuer, (2008), 9; Subedi (2008), 161; Dolzer (2005), 953; Dugan *et al* (2008), 6-7; Akinsanya (1987), 58.

<sup>16</sup> Alvarez (2011), 620-621. Also see Yackee (2008), 815 challenging Guzman's findings.

<sup>17</sup> Poulsen (2011), 114-151.

<sup>18</sup> See Sauvart and Sachs (2009), which documents studies showing the effect of investment treaties on FDI flows. The prominent studies on this relationship are - Neumayer and Spees (2005); Tobin and Rose-Ackerman (2006); Salacuse and Sullivan (2005); Driemeyer (2003).

<sup>19</sup> Neumayer and Spees (2005), 1567.

<sup>20</sup> Salacuse and Sullivan (2005), 67.

<sup>21</sup> See Aisbett (2009), 395; Yackee (2010), 397; Poulsen (2010); Driemeyer (2003). Also see Vandevelde (2005), 184.

<sup>22</sup> Vandevelde, (1998), 522-525; Robin (1984), 942-43; UNCTAD (1998); Kotera (2008), 624.

<sup>23</sup> Id.

foreign investment is more related to macro economic factors such as host country's overall economic stability, advantages as a location, level of infrastructure and other related factors.<sup>24</sup>

From the perspective of capital exporting countries, greater liberalisation and cross border investment flows has meant more and more investors are investing abroad and, as a result, subjecting themselves to the sovereign powers of the host state. This, in turn, has increased the demand for international investment law to regulate the relationship between investors and host states.<sup>25</sup> The weakness and vagueness of customary international law (CIL) and also of contractual guarantees given by countries to investors has strengthened the need to develop an international investment law regime.<sup>26</sup> This international investment law regime has been developing in the form of IIAs.<sup>27</sup> It has been argued that the ascend in the number of IIAs can be seen as an endeavor to develop international investment law as a new regulating structure where foreign investment has the benefit of treaty based protection and where investor-state arbitration is used to police state's regulatory conduct.<sup>28</sup> Furthermore, since there is no multilateral treaty for investment protection, capital exporting countries are relying more and more on IIAs to develop higher treaty protection standards for their investment.<sup>29</sup>

## ***1.2 REGULATORY POWER OF THE HOST STATE***

A comprehensive discussion on 'regulation' is beyond the scope of this work. However, a brief discussion of the concept of 'regulation' is important to understand the meaning of

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<sup>24</sup> Salacuse (1990), 673; Also see Vandevelde, (1998), 524. Data on FDI flows on the basis of country of origin into India shows that US has been the second largest investor in India after Mauritius (10% of total FDI flows in India from 2000-07 originated from the US) - Gopalan and Rajan (2009). Another example is of Brazil that has no IIAs, but is still one of the leading recipients of FDI in Latin America – see Whitsitt and Vis-Dunbar (2008).

<sup>25</sup> Chill (2009), 3.

<sup>26</sup> Guzman (1998), 679; Tobin and Ackerman (2005), 7; Dugan *et al* (2008), 51-53; Dolzer and Stevens (1995), 2; UNCTAD (1998), 7; Newcombe and Paradell (2009), 40-41. Also see Sornarajah (2008), 199-223, who has argued that growth in the number of IIAs was a result of the extension and expansion of the neo liberal agenda. This view has been critiqued by Jose Alvarez. See Alvarez (2011), 607. Also see Vandevelde (1998), 502; Lowenfeld (2003), 127.

<sup>27</sup> See Salacuse (2010), 5-6 who has conceptualized the mass of investment treaties as constituting a regime.

<sup>28</sup> See Chill (2009), 1-10. Also see Vandevelde (2009), 30-64 that describes the first and the second wave of the US IIA programme where IIAs developed for legal, economic and political objectives in mind. Also the German IIA programme focused on creating a favourable treaty protection regime for foreign investments – see Poulsen (2011), 102-107 for more details.

<sup>29</sup> Newcombe and Paradell (2009), 42. Also see Chalamish (2009), 305 – for the argument that lack of a multilateral agreement on investment has also played a role in more and more IIAs coming into existence. In this regard, it is also interesting to note the argument that the MFN provision in the present IIAs is converting the present regime of bilateral investment treaty protection into a multilateral framework – see Chalamish (2009); Schill (2009).

‘regulatory power’, a term, used in the entire thesis. Developing a working definition of ‘regulatory power’ will be useful in understanding the analysis in the forthcoming chapters.

It is difficult to define regulation. The definitions of regulation have hovered around the conceptualisations of centred regulation and decentred regulation. Centred regulation means that regulation involves only the state; whereas decentred regulation means that regulation, as an activity, also involves non-state actors such as Inter Governmental Organisations (IGOs) and Non Governmental Organisations (NGOs); and that ‘regulation’ is a broader social phenomenon than ‘law’ in the sense ‘regulation’ does not need to emanate from the state, and ‘law’ can thus be seen as one form of regulation.<sup>30</sup> Since this work is about the regulatory power of host states, it will focus on the centred regulatory concept. This is, of course, not to say that decentred regulatory conceptualisation has no role to play in the debate on IIAs and regulatory power. However, the regulatory role of non state actors in the host state, in case of IIAs, is outside the scope of this work.<sup>31</sup>

Centred regulation can be understood in two different ways. First, regulation is the promulgation of rules by government accompanied by mechanisms for monitoring and enforcement, usually assumed to be performed through a specialist public agency.<sup>32</sup> This is a narrow understanding of regulation because here regulation is carried out only by specialist public regulatory bodies mainly aimed at correcting market failures and it generally excludes redistributive policies of the state from the ambit of regulation.<sup>33</sup> Thus, according to this understanding of regulation, state providing subsidies to industries set up in economically backward region is not regulation.

Second, regulation is any form of state intervention in the economy, whatever form that intervention might take.<sup>34</sup> This is a broader understanding of regulation under which the state may intervene not just through specialist regulatory bodies like the regulatory body for the telecom sector, but also through direct state intervention. Thus, according to this

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<sup>30</sup> For more on this see Black (2002), 1; Black, (2001), 54; Smith, (2002), ?; Baldwin, Scott and Hood, (1998); Morgan and Yeung (2007). It is interesting to note the argument that there exists a web of regulatory mechanisms and law is just one strand, albeit a particularly significant one, in the complex web of regulatory mechanisms. For more on this see – Braithwaite and Parker (2004), 270-271; Black (2004), 34.

<sup>31</sup> For a discussion on the role of non-state actors in this debate see Muchlinski (2008), 8-9; Kawahru (2010).

<sup>32</sup> Majone (1996).

<sup>33</sup> Krajewski (2003).

<sup>34</sup> For more on this see Black (2002), 11. Also see Mitnick (1980).



understanding, regulation is state's intervention through various policies and measures to control, order or influence the behavior of others.<sup>35</sup> In this thesis, regulation is understood in this broader sense. On this basis, one can define regulatory power as 'the ability of the host state to adopt policies and laws to achieve a variety of policy objectives'.<sup>36</sup>

### **1.3 GLOBAL DEBATE ON IIAs AND REGULATORY POWER**

Right to regulate is the sovereign prerogative of a country arising from the control over its own territory;<sup>37</sup> however, IIAs require countries to exercise this sovereign right in accordance with their obligations for the protection of foreign investors. This brings IIAs and host country's regulatory power face to face. One can conceptualise the relationship between IIAs and host country's regulatory power in different ways such as it can be argued that IIAs result in 'regulatory chill' in the host state.<sup>38</sup> As per this argument, host country does not exercise its regulatory power because it perceives that its regulations may violate the IIA for which it can be sued by the investor, resulting in a 'chilling effect'.<sup>39</sup> Testing this hypothesis will require an investigation and documentation of cases where the host country was constrained from exercising its regulatory power because it thought the concerned regulation would violate the IIA. This hypothesis has been challenged on the ground that regulators in host states are often not aware of IIAs and of disputes that can be brought under them.<sup>40</sup> It has also been argued that it is difficult to find such cases '*because they require counter-factual evidence about the regulations that would have existed in the absence of the purported chilling*'.<sup>41</sup> In similar vein, it has been argued that even if regulators in the host state adopt a regulatory measure under the belief that such measures are compatible with the IIA, they however abandon them when threatened to be sued by foreign investors under the IIA.<sup>42</sup>

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<sup>35</sup> Black (2002), 25. Also see Reagan (1987), 15.

<sup>36</sup> In this regard, it has also been argued that under this type of regulation countries regulate not just in public interest but also in private interest. See Ogus (1994); Krajewski (2003), 11-21. Also see Morgan and Yeung (2007), 8-9 for the argument that theories on regulation can be divided in three categories – 'public interest' 'private interest' and 'institutionalist' approach.

<sup>37</sup> WIR (2003), 145.

<sup>38</sup> See Tienhaara (2009), 262; High Commissioner for Human Rights (2003), 21; Schill (2007), 470.

<sup>39</sup> See Bonnitcho (2011), 133-137.

<sup>40</sup> Coe Jr and Rubins (2005), 599.

<sup>41</sup> Bonnitcho (2011), 134; Neumayer (2001), 78.

<sup>42</sup> See Tienhaara (2011), 607; Mann (2007), 5.

Tienhaara supports the regulatory chill hypothesis by giving examples of such cases from NAFTA and Costa Rica.<sup>43</sup> The inherent assumption in the ‘regulatory chill’ hypothesis is that regulators in host states have full knowledge about IIAs and of the disputes that can be brought against them under such international treaties. However, this assumption is challengeable especially in context of developing countries where officials have inadequate knowledge about IIAs.<sup>44</sup> This is more so in case of countries that have inadequate or negligible experience in defending their regulatory measures in ITA. In other words, it is possible that regulators in a country might start internalising IIAs in their exercise of regulatory power, if previously foreign investors have challenged their regulations under IIAs. However, even this depends on various factors such as whether regulators in developing countries have the internal technical capacity to do so.

Another conceptualisation of the relationship between IIAs and regulatory power can be in terms of ‘IIA disputes’. As per this conceptualisation, the host country, unaware of the implications of IIAs, exercises its regulatory power, which the foreign investor challenges under ITA. Hence, the ITA tribunal gets to decide whether the regulatory measure of the host country is legal or not by interpreting the concerned IIA. In other words, the legality of the host country’s regulatory measure will depend on the interpretation of different provisions of the IIA. This, in turn, will shift the focus on how different provisions of the IIA are worded and whether these provisions balance investment protection with regulatory power. If an ITA tribunal comes to the conclusion that the regulatory measure of the host state is illegal, it will require the host state to pay damages to the foreign investor. Paying damages to the foreign investor will increase the cost of regulation, which may deter the host country from adopting such regulations in future. Although the ITA tribunal will not require the host state to remove the regulatory measure, the host country will not like to be seen as pursuing a regulatory measure that has been found illegal under international law since this may affect the reputation of the host country as an attractive destination for foreign investment. Further, continuance of such regulatory measure may encourage other foreign investors to challenge the measure.

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<sup>43</sup> Tienhaara (2011), 617-626. Also see Bonnitcha (2011), 137-139.

<sup>44</sup> See Poulsen (2011). Also, as the thesis will show in chapter 2, in India there is very low level of awareness amongst officials about the full implications of IIAs.

In other words, as per this conceptualisation, the relationship between IIAs and host country's regulatory power is to be understood in terms of the potential disputes that can be brought against the host country for violating IIAs. Hence, the focus here is on understanding the nature of IIAs signed by that country. This conceptualisation is best suited to understand the relationship between IIAs and regulatory power in case of countries where there is poor knowledge about the implications of IIAs and hence IIAs have not been internalised in the exercise of regulatory power.<sup>45</sup>

### 1.3.1 Recognition of Conflict between IIAs and Regulatory Power

IIA disputes between foreign investors and host states have covered a very wide array of regulatory measures such as environmental policy;<sup>46</sup> sovereign decisions regarding privatisation;<sup>47</sup> regulatory issues related to supply of drinking water;<sup>48</sup> urban policy;<sup>49</sup> monetary policy;<sup>50</sup> laws and policies related to taxation;<sup>51</sup> policy related to re-organisation of public telephone services;<sup>52</sup> industrial policy related to sectors like media;<sup>53</sup> financial services;<sup>54</sup> banking;<sup>55</sup> energy;<sup>56</sup> public postal services;<sup>57</sup> electricity services;<sup>58</sup> motorway construction;<sup>59</sup> tourism;<sup>60</sup> and many others.<sup>61</sup> In a number of cases against Argentina,<sup>62</sup> the

<sup>45</sup> See Chapter 2 for this issue in context of India.

<sup>46</sup> *Metalclad Corporation v. United Mexican States* 5 ICSID 236; *Methanex Corporation v United States of America* (2005) 44 ILM 1345.

<sup>47</sup> *Eureka BV v Republic of Poland*, ICSID Case No ARB/01/11, 19 August 2005

<sup>48</sup> *Biwater Gauff Ltd v United Republic of Tanzania*, ICSID Case No. ARB/05/22, 24 July 2008.

<sup>49</sup> *MTD Equity v Republic of Chile* (2005) 44 ILM 91.

<sup>50</sup> *CMS Gas Transmission Co v Argentina*, ICISD Case No ARB/01/8; *CMS Gas Transmission Company v Argentina*, ICSID Case No ARB/01/8 (Annulment Proceedings); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3; *Enron Creditors Recovery Corp v Argentina* ICSID Case No ARB/01/3 (Annulment Proceeding); *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16; *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16 (Annulment Proceedings); *LG&E Energy Corporation v Argentina*, ICISD Case No ARB/02/1; *Continental Casualty Company v Argentina*, ICSID Case No ARB/03/9.

<sup>51</sup> *Occidental Exploration and Production Co v Republic of Ecuador*, LCIA Case No UN 3467; *EnCana Corporation v Ecuador*, London Court of International Arbitration, 3 February 2006; *Feldman v Mexico*, ICSID Case No ARB(AF)/99/1.

<sup>52</sup> *Telenor Mobile Communications v Republic of Hungary*, ICSID Case No ARB/04/15.

<sup>53</sup> *CME v Czech Republic*, UNCITRAL Arbitration Proceedings, September 3, 2011; *R S Lauder v The Czech Republic*, 9 ICSID Reps 66, 3 Septemebrr 2001.

<sup>54</sup> *Fireman's Fund Insurance Company v Mexico*, ICSID Case No. ARB(AF)/02/01, 17 July 2006.

<sup>55</sup> *Saluka Investments v The Czech Republic* (Partial Award), UNCITRAL, 17 March 2006.

<sup>56</sup> *Duke Energy Electroquil Partners v Republic of Ecuador*, ICSID Case No. ARB/04/19, 18 August 2008.

<sup>57</sup> *United Parcel Service of America v Canada*, Arbitration Under Chapter 11 of NAFTA, 24 May 2007.

<sup>58</sup> *Nykomb Synergetics v Republic of Latvia*, Stockholm Chamber of Commerce, 16 December 2003.

<sup>59</sup> *Bayindir Insaat Ticaret VeSanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29

<sup>60</sup> *Waguih Elie George v Egypt*, ICSID Case No. ARB/05/15, 1 June 2009.

<sup>61</sup> Dolzer and Schreuer (2008), 7-8; Kaushal (2009), 511-512; Footer (2009), 39-42.

core issue has been whether Argentina's regulatory measures to safeguard its economy from a complete collapse violated the obligations that Argentina undertook in its IIAs. As it will be discussed in the thesis, many ITA tribunals have concluded that Argentina could not suspend its treaty obligations even in response to an extremely severe financial, economic, social and political crisis.<sup>63</sup> There have also been cases where ITA tribunals have adjudicated over the actions of the judiciary.<sup>64</sup> One key example that best illustrates the conflict between investment protection and host state's regulatory power is the challenge posed by foreign investors to the South African legislation (Minerals and Petroleum Resources Act) aimed at empowering the participation of Blacks in the South African mining industry.<sup>65</sup> Another example demonstrating the wide net of IIAs capable of catching many sovereign regulatory functions as potential violations of the IIA is Philip Morris, a tobacco company, challenging Uruguay's public health measure aimed at regulating cigarette packaging as a violation of the Switzerland-Uruguay IIA.<sup>66</sup> Philip Morris (Asia) Limited has also given a notice to the Australian government on the cigarette plain packaging requirements under Australia's IIA with Hong Kong.<sup>67</sup>

In other words, many sovereign decisions of host countries<sup>68</sup> have been adjudicated by arbitral tribunals as violations of the IIA.<sup>69</sup> Furthermore, there are examples in ITA where similar set of facts<sup>70</sup> or even the same provision of an IIA<sup>71</sup> has been interpreted differently

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<sup>62</sup> *CMS v Argentina*; *CMS Gas Transmission Company v Argentina*, (Annulment Proceedings); *Enron Corporation v Argentina*; *Sempra Energy International v Argentina*; *LG&E Energy Corporation v Argentina*; *Continental Casualty Company v Argentina*.

<sup>63</sup> See *CMS v Argentina*; *Sempra v Argentina*; *Enron v Argentina*

<sup>64</sup> *Saipem SpA v Bangladesh*, ICSID Case No ARB/05/7, 30 June 2009.

<sup>65</sup> *Piero Foresti et al v South Africa*, Case No ARB(AF)/07/1, 4 August 2010.

<sup>66</sup> See Porterfield and Byrnes (2011), 3.

<sup>67</sup> For more on this issue see Voon and Mitchell (2011), 515.

<sup>68</sup> Dolzer and Schreuer (2008), 7-8; Kaushal (2009), 511-512.

<sup>69</sup> This is not to suggest that in each of these disputes, the host state's regulatory measure was found illegal. In fact, limited empirical work done in this area (based on 52 decided cases), shows that in 20 cases foreign investors were awarded damages whereas in 30 cases host countries paid nothing to foreign investors – see Franck (2007). Sornarajah has critiqued this by arguing that one should not look merely at the results of investment disputes but also at the nature of pro-investor doctrines created by arbitrators on the basis of treaty interpretation – Sornarajah (2010), 235. Also see Gallagher and Shrestha (2011), which challenges Franck's study. It has been rightly argued that though ITA uses a private law adjudication model based on arbitration followed in international commercial arbitration (ICA), it addresses public law questions and hence the nature and character of ITA is very different from ICA – see Van Harten (2007); Schill (2010). Also see Salacuse (2010), 354-355; Van Harten and Loughlin (2006), 121; Montt (2009). Also see Mills (2011), 469

<sup>70</sup> The most commonly stated example of this is the 'Lauders case' where two arbitration tribunals gave different decisions to essentially the same set of facts for disputes brought under two different IIAs. The cases are – *CME Czech Republic BV v Czech Republic*, 13 September 2001, 14 (3) World Trade and Arbitration Material 109 and *Lauder (Ronald) v Czech Republic*, 3 September 2001, 4 World Trade and Arbitration Materials 35.

<sup>71</sup> The Argentine cases on Article XI of the US-Argentina IIA are a good example of such inconsistency. C H Brower II (2009), 343-348. This is not to suggest that, with passage of time, there cannot be a movement

by tribunals. The ITA rulings have also resulted in award of substantive damages to foreign investors,<sup>72</sup> and thus have resulted in diversion of taxpayer's money to foreign investors. For these reasons, many question the entire ITA system and use terms like 'legitimacy crisis' to describe it.<sup>73</sup>

There may be disagreements regarding whether the term 'legitimacy crisis' is appropriate to describe the current state of affairs in the ITA system or some alternative term should be used.<sup>74</sup> However what cannot be ignored is that adjudication of such large gamut of sovereign regulatory powers of host states by ITA tribunals as breaches of IIAs, which have the potential of affecting a large part of the population of the host state, certainly raises questions about the relationship between IIAs and host country's regulatory power.<sup>75</sup>

State practice of different countries such as Latin American countries and other developing and developed countries like the US and Canada<sup>76</sup> reveal the acceptance of a problem between IIAs and host country's regulatory power. This state practice, mentioned below, is in response to the experiences of these countries with ITA.<sup>77</sup> Some countries have taken the extreme step of denouncing the system; whereas some are critically reviewing their existing

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towards a common set of interpretative principles or that there is no possibility of uniform jurisprudence emerging through adjudication that balances investment protection with host state's regulatory power, in the future. Such convergence might happen in future with more and more investment treaty disputes coming up for resolution – see Cheng (2006), 1014. However, the formidable challenge of reconciling different tribunals interpreting different IIAs remains. For a different view point on the issue of divergent interpretation see – Alexandrov (2011), 60.

<sup>72</sup> For example in *CME Czech Republic B.V. v. Czech Republic*, Czech Republic paid US \$ 355 million to CME as damages for violating the IIA on account of adopting a regulatory measure. As per one study on NAFTA – to date, Canada has paid damages to the tune of \$ CAD 157 million to NAFTA claimants; Mexico has paid damages more than \$187 million; interestingly US has not paid any damage as it has never lost a NAFTA case. Also all three NAFTA countries have incurred significant costs in defending their claims – Canadian Centre for Policy Alternatives (2010), NAFTA Chapter 11 Investor-State Disputes available at <http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2010/11/NAFTA%20Dispute%20Table.pdf>.

<sup>73</sup> See Van Harten (2007), 63; Franck (2005), 1521; Schneidermann (2000), 757; Kaushal (2009) 491; Waibel, *et al* (2010), xxxvii – li; Brower and Steven, (2001), 193; Laird (2001), 223; Howse, (2008), 72-73; Schneidermann (2008), 69; Newcombe (2007) 394; Bottini (2008), 145; Karl (2008) 231-38; Choudhary (2008), 775-831; Muchlinski (2009), 1; Ruggie (2009); Subedi (2006), 121; Joubin-Bret (2009), 145; Spears (2010). In this regard also see Moloo and Jacinto (2011), 1. One scholar has argued that investment rules regime imposes constitution-like limits on state regulatory capacity - Schneidermann (2008), 77-78.

<sup>74</sup> Bjorklund (2011). The Rapporteur's Report admits that while there are differences in terms of the gravity of the crisis in ITA system, there is recognition that ITA system has problems that require attention.

<sup>75</sup> Wells (2011). Also see Schill (2011), 69 who states '*the extent to which investment treaties limit a state's regulatory powers and subject the exercise of such powers to liability claims by foreign investors may become the litmus test for the future viability of the system*'.

<sup>76</sup> See the separate and concurring opinion of B Schwartz on *SD Myers v Canada*, 12 November 2000 available at <http://www.naftalaw.org/Disputes/Canada/SDMyers/SDMyersMeritsAwardOpinion.pdf>; Herman (1998), 121; Mann (2000), 405. Brower II (2001), 43.

<sup>77</sup> Garcia-Bolivar (2009), 470-474;

IAs.<sup>78</sup> Bolivia and Ecuador gave up their membership of the International Centre for the Settlement of Investment Disputes (ICSID).<sup>79</sup> In 2008, Ecuador terminated nine IAs.<sup>80</sup> Recently, on 24 January 2012, Venezuela sent a notice to the World Bank denouncing the ICSID convention.<sup>81</sup> In July 2009, Russian Federation terminated the provisional application of the Energy Charter Treaty.<sup>82</sup> Venezuela also announced its intention to renegotiate 25 IAs.<sup>83</sup> Previously, Venezuela had sent a notice terminating its IIA with Netherlands because it felt that the particular IIA came in the way of implementing policy changes in its energy sector.<sup>84</sup> Many Latin American countries are developing new model IAs keeping in mind the concerns such IAs can have on their regulatory powers.<sup>85</sup>

In 2009, South Africa began a review of its entire IIA programme partly necessitated by various arbitral claims made against it.<sup>86</sup> The South African government admits that in its endeavour to make the country an attractive destination for foreign investment, it entered into IAs without critically evaluating their impact on policy-making in critical areas.<sup>87</sup> This, according to the South African government, happened because of the inexperience of their negotiators and lack of knowledge about investment law.<sup>88</sup>

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<sup>78</sup> Also see Spears (2011), 272-275.

<sup>79</sup> List of Contracting States and other Signatories to the ICSID convention (as on 7 January 2010) online pdf <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language=English>. For detailed discussion on the legal effect of these denunciations see Tzanakopoulos (2011), 75; UNCTAD (2010). Bolivia has faced three ITA disputes so far - *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, 21 October 2005; *Guaracachi America, INC.(USA) and Rurelec PLC (UK) v. The Plurinational State of Bolivia*, UNCITRAL, PCA Case No.AA406, *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2. Ecuador has faced 14 ITA disputes - [http://italaw.com/alphabetical\\_list\\_respondant.htm](http://italaw.com/alphabetical_list_respondant.htm)

<sup>80</sup> Denunciation of the ICSID Convention and BITs, IIA Issues Note No 2 (December 2010) online [http://www.unctad.org/en/docs/webdiaeia20106\\_en.pdf](http://www.unctad.org/en/docs/webdiaeia20106_en.pdf).

<sup>81</sup> Venezuela Submits a Notice Under Article 71 of the ICSID Convention available at <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement100>. Venezuela has faced 10 ITA disputes so far - [http://italaw.com/alphabetical\\_list\\_respondant.htm](http://italaw.com/alphabetical_list_respondant.htm)

<sup>82</sup> Salacuse (2010), 470; Salacuse (2010), 427.

<sup>83</sup> Venezuela follows Bolivia and Ecuador with Plans to Denounce ICSID Convention available at <http://www.herbertsmith.com/NR/rdonlyres/CFE8282C-A5F0-40CA-805E-915A7864D2A7/0/VenezuelafollowsBoliviaandEcuadorwithplanstodenounceICSIDConvention.html>

<sup>84</sup> Peterson (2008).

<sup>85</sup> Analysis: Latin America's New model Bilateral Investment Treaties, Investment Treaty News, 17 July 2008 available at <http://www.iisd.org/itn/2008/07/17/in-depth-latin-america-s-new-model-bilateral-investment-treaties/>

<sup>86</sup> Department of Trade and Industry, Republic of South Africa, Notice 961 of 2009, online <http://www.info.gov.za/view/DownloadFileAction?id=103768>.

<sup>87</sup> Id.

<sup>88</sup> Id. See Poulsen (2011), 300-322, which undertakes a detailed historical analysis of the South African IIA programme and confirms this point. Also see Muchlinski (2009), 41

Other notable developments on state practice include recognition by developed countries like Australia, United States, Canada and Norway of conflicts between investment protection and host country's regulatory power. Australia has recently decided not to have investor-state dispute resolution mechanism in its trade agreements,<sup>89</sup> and has made it clear that it is against all provisions that come in way of making laws for social, environmental and economic purposes. This is in clear response to the notice given by Philip Morris (Asia) Limited challenging Australia's tobacco regulations.<sup>90</sup> Similarly, in 2001, NAFTA Free Trade Commission (FTC) – a body composed of the representatives of all the three NAFTA states issued a note of interpretation aimed at limiting and rejecting the expansive interpretation given by arbitral tribunals on the meaning of fair and equitable treatment (FET).<sup>91</sup> Furthermore, Canada, in response to the concerns expressed by the civil society on the effect of investment treaties on Canada's regulatory power, adopted a new model IIA in 2004.<sup>92</sup> Even Norway developed a new model IIA in 2008, in response to concerns related to IIAs and host state's regulatory power.<sup>93</sup> Although, Norway is yet to adopt this model since concerns arose that it doesn't balance investment protection with regulation.<sup>94</sup>

In 2004, US adopted new model IIA in an effort to address the apprehensions that the 1994 model IIA didn't balance investment protection with regulatory power.<sup>95</sup> The change in the approach of the US towards IIAs came about when foreign investors started suing the US government for IIA violation.<sup>96</sup> During the initial years of its IIA programme, US had not critically mulled over the possibility of being a respondent state in IIA and hence its approach was clearly biased in favour of foreign investment.<sup>97</sup> For example, during its early wave of the IIA programme, US wanted to establish a body of state practice in support of its

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<sup>89</sup> US-Australia FTA does not contain investor-state dispute resolution. See – Gillard Government Trade Policy Statement (2011), 'Trading Our Way to more Jobs and Prosperity' available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf>

<sup>90</sup> Philip Morris sues Australian Government over Tobacco Laws (2011), The Guardian available at <http://www.guardian.co.uk/world/2011/nov/21/philip-morris-australia-tobacco-laws>

<sup>91</sup> Salacuse (2010), 225.

<sup>92</sup> Newcombe (2004).

<sup>93</sup> 'Norway Proposes Significant Reforms to its Investment Treaty Practices', *Investment Treaty News*, 27 March 2008 available at [http://www.iisd.org/itn/2008/itn\\_mar27\\_2008.pdf](http://www.iisd.org/itn/2008/itn_mar27_2008.pdf)

<sup>94</sup> 'Norway Shelves its Draft Model Bilateral Investment Treaty', *Investment Treaty News*, 8 June 2009 available at <http://www.iisd.org/itn/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty/>

<sup>95</sup> See Vandevelde (2009), 64-82 for a detailed description of the third wave of the US IIA programme focusing on the conditions that made the US change its approach towards IIAs. Also see Alvarez and Park (2003), 383-386; Vandevelde (2009); Spears (2010), 1038.

<sup>96</sup> Vandevelde (2009), 64-65; Sornarajah (2009), 291. Jose Alvarez has argued that the change in the US approach to IIAs was due to the realisation within US that it could be at the receiving end of foreign investment flows – See Alvarez (2011), 625-26.

<sup>97</sup> Id.

view on prompt, adequate and effective compensation for expropriation without emphasising on the necessity of *opinio juris*.<sup>98</sup> However, this approach changed, when foreign investors started suing US, as is evident by the defence made by US in the *Loewen*<sup>99</sup> and *ADF group*<sup>100</sup> cases.<sup>101</sup>

Even after the adoption of the 2004 model IIA, the Obama administration announced that it will ‘review the implementation of our FTAs and BITs to ensure that they advance the public interest’.<sup>102</sup> Elucidating further on this, the Chairman of the Subcommittee on Trade of the Committee on Ways and Means, while holding a hearing on investment obligations in US IIAs, said – ‘concerns have been expressed regarding these investment provisions. These concerns include: whether our FTAs and BITs give foreign investors in the United States greater rights than U.S. investors have under U.S. law; whether the FTAs and BITs give governments the regulatory and policy space needed to protect the environment and the public welfare.’<sup>103</sup> Surely, it is not coincidental that all countries who are reviewing their IIAs are those who had foreign investors bringing cases against them under IIAs.

### 1.3.2 Reasons for Conflict

A wide variety of views have been expressed on the problems affecting the ITA system. Many scholars argue that a wide range of sovereign decisions of host states are capable of being caught in the broad net of investor-state dispute settlement due to the vague and broad language of IIAs.<sup>104</sup> The provision on fair and equitable treatment, occurring in almost all IIAs, is an appropriate example of such a term whose meaning is unclear.<sup>105</sup> Such imprecise and broad provisions like FET become suitable candidates for broad and inconsistent treaty interpretations as chapter 4 of the thesis on FET discusses.<sup>106</sup> Similarly, all IIAs contain a

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<sup>98</sup> Id.

<sup>99</sup> *The Loewen Group Inc v United States*, ICSID Case No ARB (AF)/98/3.

<sup>100</sup> *ADF Group Inc v USA*, ICSID Case No ARB (AF)/00/1, 9 January 2003.

<sup>101</sup> Vandevelde (2009), 65.

<sup>102</sup> See the Advisory from the Committee on Ways and Means, Subcommittee on Trade of the United States available at <http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg53473/pdf/CHRG-111hhrg53473.pdf> Id.

<sup>103</sup> Id. See the new US Model IIA 2012 available at <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>

<sup>104</sup> See Schill (2011), 67-68; Wells (2010), 342; Spears (2010), 1040; Alavarez and Khamisi (2008), 472-478; Clodfelter (2009), 921. In this regard Brower and Schill (2009), 471 - have argued that IIA provisions are not as abroad as some contend.

<sup>105</sup> See chapter 4 on FET for an elaborate discussion on this.

<sup>106</sup> Id.



provision on expropriation without defining when it can be said that the host state has expropriated investor's investment.<sup>107</sup> The textual indeterminacy of the IIAs has resulted in divergent and inconsistent legal conclusions<sup>108</sup> and has also led to unexpected and undesired results.<sup>109</sup> Such indeterminacy has given a fair degree of discretion to ITA tribunals to interpret the terms occurring in IIAs and hence indulge in 'law-making' activity.<sup>110</sup> Problems related to such activity by *ad hoc* ITA tribunals are discussed in the thesis.<sup>111</sup>

Some scholars hold arbitral interpretation responsible for emerging problems in the ITA system, arguing that arbitrators have failed to interpret IIAs in a manner that balances interests of competing stakeholders by adopting pro-investor interpretation of IIAs to enhance investment protection.<sup>112</sup> A public statement on international investment regime supported by many leading academics says '*awards issued by international arbitrators against states have in numerous cases incorporated overly expansive interpretations of language in investment treaties. These interpretations have prioritized the protection of the property and economic interests of transnational corporations over the right to regulate of states and the right to self-determination of peoples*'.<sup>113</sup> It has also been argued that IIAs are aimed at pursuing neo-liberal policies at the cost of the regulatory power of developing countries.<sup>114</sup> Some scholars argue that arbitrators have adopted interpretations of IIAs different from what the countries had in mind at the time of drafting these treaties.<sup>115</sup>

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<sup>107</sup> See the chapter on expropriation for full discussion on this.

<sup>108</sup> For a detailed discussion on such inconsistent decisions see Franck (2005), 1558-1582. Also see Reinisch (2009), 905-908; McLachlan *et al* (2007), 88.

<sup>109</sup> Salacuse 2010, 342. See for example *Occidental Exploration v Republic of Ecuador*, LCIA Case No UN3467, 1 July 2004 – where 'like circumstances' in the national treatment provision was interpreted in an unexpected manner to compare treatment given to foreign oil company (involved in exporting oil) not with domestic oil company but with all exporters, like flower exporters. Also see cases involving Argentina where Argentina's response to an extremely severe financial crisis has been held by many arbitral tribunals as violating IIA provisions – see – Burke-White (2010), 407. These cases are discussed at different places in the thesis.

<sup>110</sup> Schill (2011), 1092-1093.

<sup>111</sup> See the substantive chapters 3, 4, 5 and 6 on expropriation, FET, capital transfer provision and Non Precluded Measures respectively.

<sup>112</sup> Sornarajah (2008), 205 and 207-208 and Karl (2008), 234-236. Also see Subedi (2008), 139-140; Subedi (2006), 128-130. Also see the argument on adopting contextual standards for developing countries for IIA interpretation owing to the low level of development of developing countries – Alexander (2008) 817-843.

<sup>113</sup> Public Statement on the International Investment Regime, 31 August 2010 available at <http://www.osgoode.yorku.ca/public-statement/documents/Public%20Statement%20%28June%202011%29.pdf>

<sup>114</sup> Sornarajah 2009; Miles (2010), 1. For a general hegemonic critique of international law making based on Marxist analysis see Chimni (2004). On this point also see Mills (2011), 501-502.

<sup>115</sup> Ewing-Chow and Teck (2008), 28.

Others hold the institutional design used to settle disputes between foreign investors and host states responsible for the problems in ITA.<sup>116</sup> The argument is that the ITA system is evidently biased against host states and in favour of foreign investors because it is not based on an impartial and independent adjudicative process.<sup>117</sup> Arbitrators are appointed on a case to case basis and many a times may act as counsel in similar sort of disputes thus raising issues related to conflict of interest.<sup>118</sup> Hence, it has been proposed to create a world investment court to act as an impartial and independent adjudicator to settle investor-state disputes.<sup>119</sup> Arguably, the absence of an appellate system in ITA that could correct the divergent interpretations of different arbitral tribunals and hence enhance certainty and predictability in the system is also responsible for the problems affecting the ITA system.<sup>120</sup> Thus, it has been proposed to build an appellate mechanism for investment treaty arbitration.<sup>121</sup>

On the other hand, some authors argue that IIAs are only going through ‘growing pains’, which will disappear as the system grows older;<sup>122</sup> and while some argue that the ITA system does not adversely affect the host state’s right to regulate.<sup>123</sup> The argument often is that under general international law host countries have the regulatory power to adopt ‘non discriminatory’, ‘good faith’ regulatory measure for public policy without attracting any international liability,<sup>124</sup> which has been recognised by many tribunals.<sup>125</sup> For example, in the context of disputes on expropriation, it is argued that regulatory measures adopted by a state as part of its ‘police power’ is not expropriation.<sup>126</sup> These arbitral rulings are discussed throughout the thesis in subsequent chapters; it is important to state here that the precise

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<sup>116</sup> Van Harten (2007).

<sup>117</sup> Id. Van Harten (2010), 433.

<sup>118</sup> Lowe (2002), 464-465. Also see Sands (2011), 19.

<sup>119</sup> Van Harten (2007). Also see Meyers (2008), 47; and Alvarez (2008), 909, – which offer a critique of Van Harten’s work.

<sup>120</sup> Franck (2005). Also see Brower II (2003), 37.

<sup>121</sup> Franck (2005). Also see Wälde (2005). Further proposals to improve the institutional design and its functioning are establishing a ‘roaster’ for the composition of the ‘tribunal’ - Karl (2008), 242; allowing for amicus curiae submissions; allowing non-parties to have access to arbitral proceedings - See generally Chaudhary (2008), 818-821.

<sup>122</sup> Stern (2011).

<sup>123</sup> See Paulson (2006); Brower & Schill, (2009), 483-489; Moloo and Jacinto (2011), 1; Krishan (2011).

<sup>124</sup> Paulsson (2006); Brower and Schill (2009), 471; Alvarez (2009), 17. Also see Newcombe (2008), 145.

<sup>125</sup> *Methanex Corporation v Mexico*, NAFTA Award (of August 3, 2005); *Tecmed v Mexico*, ICSID Case No ARB/AF (00)/2; *Feldman v Mexico*, Award, 16 December 2002, 18 ICSID Review-FILJ (2003) 488; *Saluka v Czech Republic*, para 255; *Parkerings-Campigniet AS v Lithuania*, ICSID Case No ARB/05/8, 11 September 2007, para 332. Also see *Santa Elena v Costa Rica* (Award), 5 ICSID Reports 153, 17 February 2000, and *ADC Affiliate Ltd v Republic of Hungary*, ICSID Case No ARB/03/16, 2 October 2006 who do not support this position. This discussed in different chapters of the thesis. Also see Martinez (2010), 331-336.

<sup>126</sup> See the chapter 3 on Expropriation for full details.

boundaries of justified ‘public policy’ are unclear.<sup>127</sup> The moot issue is whether an exercise of ‘police power’ by a state resulting in substantial deprivation of foreign investment can be held a regulation or an expropriatory act? Also, there is no consensus on how broad or narrow the ‘police powers’ are.<sup>128</sup> Will adopting a regulatory measure that gives incentives to domestic industry to boost indigenous industrialisation in a backward region of a country be allowed under the IIA as part of the ‘police power’ argument? Or, will a regulatory measure adopted for furthering public interest, which withdraws the assurances given to foreign investors or which changes the regulatory framework relied by the foreign investor before making the investment, be allowed under the ‘police power’ argument? There are no clear answers to these questions.<sup>129</sup>

#### ***1.4 DISCUSSION ON INDIAN IIAs IN BACKGROUND OF THIS GLOBAL DEBATE***

Given this emerging global background on IIAs and regulatory power, this thesis will discuss Indian IIAs from the perspective of India’s regulatory power, which is significant to pursue various non-investment related policy objectives. This thesis is the first-ever effort to comprehensively understand the nature and character of all Indian IIAs from the perspective of India’s regulatory power.

The right to regulate assumes even more significance for an extremely diverse, multi-ethnic, multi-religious and multi-cultural country like India where both the central and state governments have to deal with and resolve all kinds of complex problems and multitude competing interests between different stakeholders and groups. India has followed broader regulation, since its independence in 1947, where the state has adopted measures to achieve a number of public policy objectives. These include equitable distribution of wealth; balanced industrial development of all regions; protection of small scale industries; protection of environment; providing public health to all; providing primary, secondary and higher

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<sup>127</sup> Salacuse (2010), 251.

<sup>128</sup> Mostafa (2008), 272-273; Fortier and Drymer (2004), 299. Also see Subedi (2008), 164-72; *Saluka v Czech Republic*, para 263.

<sup>129</sup> Even scholars like Stephan Schill who defend the ITA system recognise that certain aspects of the system have to be critically evaluated - Schill (2011), 57. Also see Bjorklund (2011). This position is better than the position taken by the ‘unabashed cheerleaders’ [(term is borrowed from Spears (2011), 297] of the ITA system who criticise and dismiss anyone asking for a critical review of the system - see for example Krishan (2011).

education; providing tax holidays and incentives to certain industries<sup>130</sup>; pursuing independent monetary policies and pursuing other macroeconomic objectives.<sup>131</sup> Similarly, regulatory measures may also include developing and adopting policies aimed at keeping foreign investment out of certain strategic sectors or imposing certain performance requirements on foreign investment.<sup>132</sup> These generalised regulatory measures are in addition to specialised regulations, which are fairly recent in India, and are prepared by specialised regulatory bodies for specific sectors such as telecom and insurance.

As the global debate demonstrates, the exercise of many such regulatory powers by India, if they affect foreign investment, may be challenged as violation of India's IIAs. Two factors have increased India's vulnerability to challenges of regulatory measures under IIAs. First, India has signed 86 IIAs so far out of which 73 IIAs are in force.<sup>133</sup> Thus, India has bound itself to international legal regimes to protect foreign investment with many countries. Notwithstanding the significance of Indian IIAs, not much work has been done to analyse and understand them, barring few articles.<sup>134</sup>

Second, foreign investment flows to India have increased manifold from US \$ 393 million in 1992-93 to US \$ 26192 million in the financial year 2011-12 (up to January 2012).<sup>135</sup> This has increased the interaction between different layers of governments, at the centre and state levels, with foreign corporations belonging to one of the IIA partner countries of India and hence the possibility of a conflict due to the exercise of India's regulatory power. India has already faced two IIA disputes - *Dabhol power project case*<sup>136</sup> and the *White Industries case*.<sup>137</sup> Further, in recent times many examples of regulatory conflicts between Indian

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<sup>130</sup> This sort of regulation may be given to both domestic industries and also foreign industries to boost investment flows – See Vandeveld (2000), 477-478 who has argued that the interventionist approach of giving tax incentives to boost investment has its own limitations.

<sup>131</sup> For a discussion on why countries regulate see - Ogus (1994).

<sup>132</sup> Vandeveld (2000), 484-485. Vandeveld has argued that if IIAs do not allow for such regulatory interventions to be made, countries might be deterred from entering into IIAs and thus might exclude foreign investment altogether. Also see Vandeveld (1998), 621-8.

<sup>133</sup> Ministry of Finance, Government of India, Bilateral Investment Promotion and Protection Agreements available at [http://finmin.nic.in/bipa/bipa\\_index.asp](http://finmin.nic.in/bipa/bipa_index.asp)

<sup>134</sup> Rao (2000), 623; Krishan (2008), 277; Ranjan (2008), 209; Ranjan (2010).

<sup>135</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India "FDI in India Statistics" available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/2012/india\\_FDI\\_January2012.pdf](http://dipp.nic.in/English/Publications/FDI_Statistics/2012/india_FDI_January2012.pdf)

<sup>136</sup> *Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Maharashtra Power Development Cooperation Limited*, International Court of Arbitration of the ICC, Case No. 12913/MS.

<sup>137</sup> *White Industries Australia Limited v Republic of India*, UNCITRAL Arbitration, Final Award, 30 November 2011. Suzuki Corporation of Japan brought a case against India to the Court of Arbitration of the International Chamber of Commerce in 1997. However, this was not an IIA dispute but arose from an investment contract – see Takezawa (1998), 18. It is also important to mention that an Indian national has brought an IIA dispute

government and foreign investors at the national level have cropped up and some of them are on the verge of snowballing into IIA disputes (see chapter 2).

In India's case, the 'regulatory-chill' conceptualisation is not useful to understand the debate on IIAs and regulatory power because there is a very low, even negligible, level of awareness within the Indian government about IIAs entered by India (see chapter 2). Thus, the thesis will not investigate whether there have been cases where India was deterred from adopting regulatory measures due to the knowledge, on the part of the regulators, that these regulatory measures are prohibited under IIAs.<sup>138</sup> It will also not look at the regulatory measures adopted by India but later withdrawn when foreign investors threatened legal action. The thesis will use the 'IIA-dispute' conceptualisation (discussed above) to understand the debate on Indian IIAs and India's regulatory power; hence the focus will be on the substantive law *i.e.* the IIAs themselves. The thesis will find plausible interpretations of Indian IIAs and assess whether these interpretations give precedence to investment protection over India's regulatory measures.

#### 1.4.1 Outline

Chapter 2 of the thesis discusses the evolution of India's approach to foreign investment and the advent of the Indian IIA programme providing an overview of the substantive investment protection provisions in Indian IIAs. The thesis then focuses on finding the plausible interpretations of four provisions in Indian IIAs that have the closest relationship with India's regulatory power. These provisions are expropriation; FET; monetary transfer provision; and non precluded measures (NPM). The thesis hypothesises that the present formulations of these four provisions in Indian IIAs are worded broadly, and depending on the exercise of arbitral discretion can be interpreted in manners giving precedence to investment protection over India's exercise of regulatory power.

The provisions on expropriation, FET and NPM have the potential of affecting a broad range of regulatory measures whereas the provision on monetary transfer will specifically affect the

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against the UK under the India-UK IIA (*Sancheti v United Kingdom*, UNCTIRAL). However, very little is known about this particular dispute. Some details are available from an English Court judgment – *The Mayor and Commonalty & Citizens of the City of London v Ashok Sancheti Case No: B2/2008/0489, Date: 21/11/2008*.

<sup>138</sup> See Chapter 2 that shows the lack of awareness on the part of Indian policy makers about IIAs.

regulatory power related to imposing capital controls on flow of funds across borders. The provision on expropriation will play a crucial role in determining whether a regulatory measure adopted by India to achieve a non-investment related policy objective is regulation or expropriation (chapter 3). The FET provision has become ‘*the most frequently invoked standard in investment disputes*’;<sup>139</sup> and ‘*a majority of successful claims pursued in international arbitration are based on a violation of the FET standard*’.<sup>140</sup> Thus, the FET provision has a very close link with India’s regulatory power because changing an existing law or regulatory framework or adopting new laws to achieve certain policy objectives may be challenged as a violation of the FET provision<sup>141</sup> (chapter 4). The provision on monetary transfer is very important for the investor because it lays down the conditions related to transfer of funds across borders. Unrestrained transfer of funds across borders can have certain macroeconomic consequences such as appreciation or depreciation of currency. The thesis will understand whether the formulation of the monetary transfer provisions in Indian IIAs allows India to impose capital controls to achieve monetary policy objectives (chapter 5). Finally, the NPM provision is crucial as it allows the host state to deviate from investment protection in certain circumstances to achieve non-investment regulatory goals. The thesis will understand whether the current formulation of the NPM provision allows India to deviate from its IIA obligations to pursue non-investment policy objectives (chapter 6). Chapter 7 concludes by emphasising on reformulating these provisions in a manner that balances investment protection with India’s regulatory power<sup>142</sup> and identifies the key elements of the new formulation of these four provisions.<sup>143</sup>

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<sup>139</sup> Dolzer and Schreuer (2008), 119.

<sup>140</sup> Id.

<sup>141</sup> See the FET chapter for more details which discusses such cases.

<sup>142</sup> Generally on balancing rights of investors with host states see – McLachlan *et al* (2007), 21-23; Muchlinski (2006), 527; Charles H Brower II (2008), UNCTAD (2000); WIR (2003); Zarsky (2005), 1-12; Shan (2008), 303-12; Gallagher and Shan (2009), 384-414. Shan has argued that there is a resurgence of a modified form of the Calvo doctrine especially amongst the Latin American countries, which will balance investment protection with the obligations of host state. Also see the IISD Model IIA available at [http://www.iisd.org/pdf/2005/investment\\_model\\_int\\_handbook.pdf](http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf).

<sup>143</sup> See also the work of Gallagher and Shan (2009) on Chinese Investment Treaties which follows same outline discussing the features of Chinese IIAs and then putting together the elements of new formulation in the concluding chapter.

## 1.5 METHODOLOGY

Since the framework adopted by the thesis focuses on Indian IIAs, it will primarily aim at finding out what is the substantive law of investment protection - contained in 73 Indian IIAs - the primary source of this research.<sup>144</sup> This will be done by studying how each of the selected provision is defined in each of the 73 Indian IIAs by undertaking a treaty by treaty examination. A preliminary question regarding methodology may be that since the thesis is concerned with India's regulatory power as a host nation, instead of focusing on all 73 Indian IIAs, the thesis should select and study only those IIAs where India is a net capital importer.<sup>145</sup> However, the thesis has selected and studied all 73 Indian IIAs for the following reasons:

First, India is still a net capital importing country. India's net FDI flows by the end of 2010-11 stood at US \$ 9.4 billion.<sup>146</sup> India is also a net capital importing country *vis-à-vis* many developed countries. For all these foreign investment inflows, India will act as a host state needing regulatory power to pursue different policy objectives in light of the vastness of India and its diverse needs.

Second, India receives capital not just from developed countries such as the US, UK, Germany, and Italy but also from developing countries such as Malaysia, Thailand, Philippines, Indonesia, South Africa, Iran, Sri Lanka, Kenya and others.<sup>147</sup> Even if, India is a net capital exporting country *vis-à-vis* some of these developing countries; nothing stops a Sri Lankan or a Kenyan investor from bringing a case against India challenging a regulatory act

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<sup>144</sup> The number of 73 IIAs includes the Indian model IIA. These IIAs are available at Ministry of Finance, Government of India - [http://finmin.nic.in/bipa/bipa\\_index.asp](http://finmin.nic.in/bipa/bipa_index.asp). Further, all the Indian IIAs studied in this thesis are available in the Official Compendium of Bilateral Investment Promotion and Protection Agreements, published by Ministry of Finance, Government of India, September 2011.

<sup>145</sup> See Krishan (2008), 308 who argues that India should have two model IIAs depending on capital exporting and importing status. Countries like the US have faced such dilemmas - the US IIA programme that was initially designed to regulate the behaviour of host states, (mainly developing countries) so as to protect investments made by US nationals in these states, has undergone changes - with the most prominent change being the 'self interpreting' nature of the clause for the protection of essential security in the 2004 US Model IIA. While the US policy makers knew that adoption of a 'self interpreting' measure will give more leeway to treaty partners of US in treating investments made by US nationals, they were happy to pay this price in return for ensuring that their own regulatory power to take measures in certain exigencies is not jeopardised - for more on this see Vandevelde (1993), 170; Gagne and Morin (2006), 357.

<sup>146</sup> Economic Survey (2012), 136.

<sup>147</sup> Bera and Gupta (2009).

allegedly violating the IIA.<sup>148</sup> In other words, disputes can arise with investors, irrespective of the fact whether India is a net capital exporter or importer *vis-à-vis* a particular country. Moreover, capital exporting or importing country status is not a static one. This is corroborated by India's own experience. When India started its IIA programme in 1994, India was not a major exporter of capital. In fact, till 2000-01, India's outward investments were close to only US\$ 2000 million. This increased, by more than seven times, to being more than US\$ 15000 million by the end of 2010-11.

Third, having different IIAs based on capital exporting or importing interest will result in inconsistent treaty practice adding unnecessary confusion amongst India's IIA partner countries and foreign investors, regarding India's foreign investment protection policy.

Fourth, the Indian investment treaty practice is itself contrary to this argument. India has started inserting provisions that boost India's regulatory power in some of the IIAs only in recent years, *i.e.*, during the time when India is emerging as an exporter of capital and that too with countries with whom India has an offensive interest such as countries in Africa. For example, few recent Indian IIAs state that the purpose behind regulatory measure should be taken into account in determining expropriation (see chapter 3).

Fifth, the presence of the MFN provision could be used to borrow beneficial provisions from other treaties in case the primary treaty is not investor friendly.<sup>149</sup>

These 73 Indian IIAs will be examined to find out how many of them include a particular provision being studied (in a particular chapter); and out of the IIAs that cover this provision – what are the differences in text or language for each of these provisions. This information will then be organised in a tabular form in each of the chapters.<sup>150</sup>

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<sup>148</sup> For example, there have been investor-state cases brought by investors from developing countries like – Argentina, Malaysia, Chile, Peru, Russian Federation – see Franck (2005), 28.

<sup>149</sup> Gallagher and Shan (2009), 384-95.

<sup>150</sup> Also see Tudor (2008), 16-18 for following a similar methodology. Although this particular study collected and tabulated empirical information about only one feature (fair and equitable treatment standard) for different IIAs signed by different countries as against the methodology of this thesis namely different features in the IIAs of the same country (India).



Once this information is collated, the thesis will interpret these provisions using the treaty interpretation tools given in Articles 31 and 32 of the VCLT.<sup>151</sup> Although India is not party to VCLT;<sup>152</sup> it can still be used to interpret Indian IIAs in light of the fact that treaty interpretation rules are widely recognised as part of CIL.<sup>153</sup> A treaty has to be interpreted using the treaty interpretation rules and not on the basis of some *per se* normative value without carefully studying the text of the treaty. ITA tribunals have endorsed the importance of treaty interpretation rules to interpret IIAs.<sup>154</sup>

Treaty interpretation rules require that a treaty be interpreted in good faith<sup>155</sup> by giving ordinary meaning to the words used in their context and in light of the object and purpose<sup>156</sup> (Article 31(1)). The context will have to be determined by examining the text, preamble, annexes and other factors like - any subsequent agreement between the parties on the interpretation of the treaty (Article 31(2)). Here, it is important to note treaty interpretation rules given in Article 31(2) of the VCLT are of limited value in case of Indian IIAs because rarely has India and its IIA partner countries entered into agreements related to the treaty in connection with conclusion of the treaty (barring in some IIAs on the provision on expropriation – discussed in chapter 3 on expropriation chapter). Other important factors include any subsequent practice in the application of the treaty that establishes the agreement of the parties on its interpretation (Article 31(3)(b)). The role of Article 31(3) (c) of the

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<sup>151</sup> In this regard, Professor Jackson and Professor Qureshi (for different reasons) have argued for a re-evaluation of the principles of treaty interpretation applicable to the WTO treaty. See Jackson (2006), 184 and Qureshi (2006), 4-7.

<sup>152</sup> United Nations Treaty Collection (1 July 2011) available at [http://treaties.un.org/pages/ViewDetailsIII.aspx?&src=UNTSOnline&mtdsg\\_no=XXIII-1&chapter=23&Temp=mtdsg3&lang=en](http://treaties.un.org/pages/ViewDetailsIII.aspx?&src=UNTSOnline&mtdsg_no=XXIII-1&chapter=23&Temp=mtdsg3&lang=en).

<sup>153</sup> Gardiner (2008), 16.

<sup>154</sup> For example, in *Siemens A G v Argentina* (Decision on jurisdiction, 3 August 2004, para 80) the tribunal said that the IIA should neither be interpreted liberally or narrowly but according to the rules of interpretation given in the VCLT. Also see *AES Corp. (US) v Argentina*, ICSID Case No ARB/02/17, para 30 (Decision on Jurisdiction), 26 April 2005. In this regard, also see the *Mox Plant* case: it was stated that application of international law rules on interpretation of treaties to identical and similar provisions of different treaties may not yield the same results - *Ireland v United Kingdom*, 2001 ITLOS No 10, para 51 (3 December).

<sup>155</sup> In this regard it is important to note that ‘good faith’ in Article 31(1), in the context of WTO agreements has been interpreted to mean two things – first, ‘effective treaty interpretation’, and second, ‘interpretation should not lead to a result which is manifestly absurd or unreasonable – see Qureshi (2006), 12-15.

<sup>156</sup> Finding the object and purpose — the aims of the treaty — is extremely important to shed light on the ordinary meaning of the terms, especially when the terms used in the treaty are capable of different interpretations - see Gardiner (2008: 190). *USA, Federal Reserve Bank v Iran, Bank Markazi*, Case A28, (2000-02) 36, Iran-US Claims Tribunal Reports, 5 at 22, para. 58.

VCLT, which states that any relevant rule of international law applicable in the relations between the parties shall also be taken into account, is also important in this regard.<sup>157</sup>

Article 32 of the VCLT provides for the supplementary means of treaty interpretation which include the preparatory work of the treaty and the circumstances of its conclusion in order to confirm the meaning derived from application of Article 31 or to determine the meaning when the interpretation according to the particular leaves the meaning ambiguous or leads to a result which is manifestly absurd or obscure.<sup>158</sup> It is difficult to find the negotiating history of IIAs that can assist in interpretation.<sup>159</sup> In case of Indian IIAs, this treaty interpretation rule is of very limited value because the negotiating history of none of the IIAs is available. Arguably, model IIAs constitute ‘preparatory work’ within Article 32 of the VCLT.<sup>160</sup> The thesis discusses India’s model IIA;<sup>161</sup> however, many of the provisions in such an IIA are as vague and indeterminate as the provisions in the treaty itself and hence model IIA is of limited value in this regard. The Indian model IIA, adopted in 1994,<sup>162</sup> is heavily inspired by the first IIA that India entered with the UK in 1994.<sup>163</sup>

This treaty interpretation will adequately reflect upon the differences in treaty language occurring in the text of these provisions. These differences are important as they will have different implications on regulatory power. The process of treaty interpretation will focus at finding plausible interpretations and then assessing the effect of these interpretations on ‘regulatory power’ of India to find out whether the provision balances investment protection with regulatory power or not. This process of treaty interpretation using the rules of treaty interpretation will be aided by taking into account the case law developments in ITA. Like international law, there is no doctrine of binding precedent in ITA. However, referring to past arbitral tribunal awards becomes necessary in interpreting IIA provisions because of their vague and indeterminate nature.<sup>164</sup> Such IIA provisions imply that application of rules of

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<sup>157</sup> For detailed discussion on Article 31(3)(c) see Gardiner (2008), 251-80. On the use of Article 31(3) (c) of the VCLT in interpreting IIAs see McLachlan (2008); Paparinskis (2011), 65.

<sup>158</sup> *Plama Consortium Ltd v Bulgaria*, ICSID Case No ARB/03/24 used Article 32 of the VCLT to interpret the MFN provision in the Bulgaria-Cyprus IIA.

<sup>159</sup> Salacuse (2010), 154.

<sup>160</sup> *Id.*, 155.

<sup>161</sup> Indian Model Text of Bilateral Investment Promotion and Protection Agreement, Ministry of Finance, Government of India, available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/icsection/Indian%20Model%20Text%20BIPA.asp](http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp)

<sup>162</sup> Saxena (2010).

<sup>163</sup> Krishan (2008), 297.

<sup>164</sup> Salacuse (2010), 155-56.

treaty interpretation may not be sufficient, on its own, to find the meaning of the treaty provisions.<sup>165</sup> Hence, it becomes imperative to use other tools such as past arbitral decisions to understand how similarly worded provisions in other IIAs have been interpreted by arbitral tribunals to understand the meaning of these terms in Indian IIAs. All arbitral tribunals extensively refer to past arbitral decisions.<sup>166</sup> Further, reference to past arbitral decisions is also important to show the consistency or lack of it in interpreting similar provisions and to demonstrate arbitral discretion, which play a major role in determining what impact is caused on host country's regulatory power. The existence of this arbitral discretion can also be used to argue for carefully reviewing the existing substantive law, *i.e.*, the IIAs. Furthermore, since the thesis conceptualises IIAs and India's regulatory power in terms of investor-state disputes, a careful and critical assessment of the ITA jurisprudence becomes an integral part of the methodology to study Indian IIAs and their impact on the exercise of India's regulatory power.

In order to ascertain the meaning of different provisions of Indian IIAs and to understand the rationale behind India's IIA programme, the researcher conducted interviews with Indian investment treaty negotiators, which is used to inform the research conducted.

### Background to the Interviews conducted

The researcher contacted more than 20 Indian government officials, past and present, of Ministry of Finance; Ministry of Commerce and Industry; and Ministry of External Affairs of Government of India. Officials from these Ministries were contacted because these ministries play major role in negotiating IIAs with Ministry of Finance being the nodal ministry that deals with IIAs (see the discussion in chapter 2 on this along with the role of other two ministries in affairs related to IIAs). Some officials didn't respond to request for an interview.

In the end, researcher interviewed 15 Indian government officials from three ministries - six from Ministry of Finance (some officials of Ministry of Finance were interviewed more than once); five from Ministry of External Affairs; and four from the Ministry of Commerce and

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<sup>165</sup> See the FET chapter. Also see Schill (2011), 1092-1093.

<sup>166</sup> In this context see the arguments for '*jurisprudence constante*' by Bjorklund (2008); and also Cheng (2006), 1014 who has argued that 'there is an informal but powerful system of precedent that constrains arbitrators to account for prior published awards and to stabilise international investment law' – at 1016. Also see Schreuer (2008), 1190; Kaufmann-Kohler (2007), 357. Also important to note that Article 38(d) of the ICJ Statute recognises judicial decisions as one of the sources of international law.

Industry. Only senior officials, past and present (officials holding the post of Director<sup>167</sup> and Joint Secretary<sup>168</sup> in the Indian bureaucratic order),<sup>169</sup> of these ministries were selected. This was done for couple of reasons. First, for logistic reasons as barring these officials no one else has the relevant information related to IIAs. For instance, the researcher contacted the office of the Additional Secretary (an official higher than Joint Secretary)<sup>170</sup> for an interview; however was told to contact either the office of the Joint Secretary or the Director thus showing their importance on matters related to IIAs. Second, since these officials hold senior and key positions in the Indian government, information shared by them could be authentically relied upon for its representativeness for the project at hand. All officials agreed to interview requests on the condition that they are quoted only anonymously. Most interviews were held in New Delhi from July 2010 to September 2010 (after obtaining approval of the ethics committee), in October-November 2010 and in November 2011. Some interviews were held over phone. After the *India-White Industries*<sup>171</sup> ruling, couple of interviews were conducted in February 2012, over the phone, with the same officials who were interviewed earlier. These interviews were done in order to understand what effect the ruling will have on the Indian IIA programme.

All these interviews were semi-structured. The theme of all the interviews with the six officials of Ministry of Finance was whether India fully understood the implications of IIAs on India's regulatory power at the time of negotiating and signing these treaties. The researcher asked these six interviewees as to why India is entering into IIAs; what it expects to gain out of it; and has India's approach to IIAs changed in light of emerging disputes between investors and other developing countries like Argentina.

The theme of all the interviews with the four officials of the ministry of commerce was the rationale behind India having a separate investment chapter in its CECAs and why these chapters differ from India's standalone IIAs. The theme of all the interviews with the five officials of Ministry of External Affairs was regarding their contribution in the process of negotiating IIAs.

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<sup>167</sup> An official of the rank of Director is the fourth senior most official in the Indian bureaucratic order.

<sup>168</sup> An official of the rank of Joint Secretary is the third senior most official in the Indian bureaucratic order.

<sup>169</sup> Also see the discussions in chapter 2

<sup>170</sup> An official of the rank of Additional Secretary is the second senior most official in the Indian bureaucratic order.

<sup>171</sup> *White Industries Australia Limited v The Republic of India*, Final Award, UNCITRAL, 30 November 2011

Most individual bureaucrats especially of Ministry of Finance and Ministry of Commerce and Industry seemed not to have an adequate understanding of IIAs. This was confirmed by the researcher asking questions related to basic features of IIAs, jurisprudence of IIAs, and the reasons why a specific provision in a particular Indian IIA differed from another IIA though both IIAs were signed by India at the same time.

In addition to the 15 officials, the researcher also interviewed two key officials each of Ministry of Environment and Ministry of Health. These ministries do not play any direct role in IIA negotiations or in international investment law policy making. The theme of the interviews with these officials was whether these ministries were aware of the existence of IIAs and whether IIAs figured in their exercise of regulatory power.

## CHAPTER 2

### INDIA'S APPROACH TO FOREIGN INVESTMENT AND THE INDIAN IIA PROGRAMME

After having understood the relationship between IIAs and regulatory power and the emerging issues thereto, this chapter outlines India's evolving approach to foreign investment since its independence (Section 2.1 and 2.2). It also introduces the Indian IIA programme providing its salient features and an overview of the substantive protection contained in Indian IIAs (Section 2.3). This is followed by discussing where India stands on the global debate on IIAs and host country's regulatory power highlighting the lack of India's internal capacity to fully understand the ramifications of IIAs (Section 2.4).

#### ***2.1 THE INDIA STORY - 1947 to 1990***

India's policy on foreign investment has evolved over the years since its independence in 1947. In the initial years after independence, India's attitude towards FDI was receptive<sup>172</sup> although India's policy was characterised by import substitution and focused on developing indigenous industries.<sup>173</sup> India's first Prime Minister, Jawahar Lal Nehru, while speaking in the Parliament on 6 April 1949 recognised the importance of foreign investment in supplementing domestic savings and helping in economic and technological progress.<sup>174</sup> FDI was sought in 1950s in mutually advantageous way with conditions like joint ventures with local industries, local content clauses and export obligation.<sup>175</sup> However, FDI during this period was also subject to careful scrutiny due to India's fragile Balance of Payment (BoP) position.<sup>176</sup> The BoP crisis of 1957-58 resulted in the Indian government encouraging foreign investments to bring in more foreign exchange to improve the BoP situation.<sup>177</sup>

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<sup>172</sup> Kumar (1998), 1321.

<sup>173</sup> For a detailed discussion on India's import substitution strategy after independence see – Bhagwati and Desai (1970).

<sup>174</sup> Palit (2009), 6.

<sup>175</sup> Nagaraj (2003), 1701; Kumar (1998), 1321.

<sup>176</sup> Palit (2009), 8.

<sup>177</sup> Kidron (1965); Kumar (1998), 1321-1322; Palit (2009), 6.

This receptive attitude to foreign investment started to change in 1970s when there was a more conscious shift towards adopting protectionist and inward looking economic policies to protect India's infant industries that had developed in the 1950s and 1960s.<sup>178</sup> A number of laws were enacted such as the Foreign Exchange Regulation Act (FERA),<sup>179</sup> which required a foreign company to convert foreign equities into minority holdings. Only if a foreign company diluted its equity to a minority holding of 40 percent would it get national treatment.<sup>180</sup> The Industrial Policy Resolution of 1977 provided a list of industries where no foreign collaboration either financial or technical was considered necessary.<sup>181</sup> Also, fully owned foreign companies were permitted in only highly export oriented and sophisticated technology areas.<sup>182</sup> This led to many transnational corporations like IBM and Coca Cola exiting India.<sup>183</sup> The GDP growth rate of India came down to 2.9 percent in 1965-1979<sup>184</sup> as against a respectable 4.06 percent from 1950-1964.<sup>185</sup>

Low economic growth, lower international competitiveness of Indian goods and low export potential of Indian manufactured goods in 1970s resulted in India adopting limited liberalisation and de-regulation in 1980s.<sup>186</sup> The post 1980s period saw a shift from import substitution strategy to an export neutral promotion strategy and witnessed a higher rate of GDP growth from about 3.5 percent annually during 1960s and 70s to 5.7 percent annually in 1980s.<sup>187</sup> This period saw a receptive attitude towards FDI signalled in some key changes such as limited flexibility was introduced in foreign ownership and exceptions introduced to the 40 percent ceiling rule.<sup>188</sup> There was an increase in inflows between 1985 to 1991,

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<sup>178</sup> Kumar (1998), 1322. Also see Palit (2009), 6-7.

<sup>179</sup> Chaudhary (1979). Another key legislation of this time was the Monopolies and Restrictive Trade Practices (MRTP) Act which aimed at restricting and controlling monopolies. However, it had an adverse impact on growth of industry since it defined monopoly in terms of size irrespective of the effect on the market and even if the size and market share of the firm concerned were small by world standards – see Nanda (2009), 750. The period also saw the nationalisation of 14 banks and of general insurance in 1972.

<sup>180</sup> Industrial Policy 23 December 1977, Department of Industrial Development, Ministry of Industry.

<sup>181</sup> Id.

<sup>182</sup> Id.

<sup>183</sup> Also see Kumar (1998) 1322; Nagraj (2003), 1701. Also see Ahluwalia (1991); Virmani (2005). Virmani divides India's post-independence economy in two parts – the period from 1950-51 to 1978-79 is referred as 'Indian Version of Socialism' and the period after 1980 till date is referred as 'market experimentation'.

<sup>184</sup> National Accounts Statistics of India, Central Statistical Organization.

<sup>185</sup> Id.

<sup>186</sup> Virmani (2005); Kumar (1998), 1322-1323. Also see Nayar (2007), 372-374.

<sup>187</sup> Virmani (2005). Also see Ahluwalia (2002), 67. GDP growing at an average of 5.7 percent for the period 1981-82 to 1990-91 - Economic Survey (2001-02), Ministry of Finance, Government of India, 2002.

<sup>188</sup> Kumar (1998), 1323.

although the annual average for all foreign investment from 1970 to 1991 was only about US\$ 99 million.<sup>189</sup>

Thus, one can say that India's attitude towards foreign investment was receptive in initial years (1950 to end of 1960s). However, even this attitude was cautious and never meant embracing foreign investment wholly but only as per need such as helping in bringing in foreign exchange or plugging the domestic savings gap.<sup>190</sup> This cautious receptive attitude changed in 1970s with a tremendous and open shift towards indigenous industries, to the extent of discriminating against foreign companies. The 1980s saw the re-emergence of this cautious receptive attitude towards foreign investment best embodied in the example of setting up of Maruti – a central government joint venture small car project with Suzuki motors of Japan in 1982.<sup>191</sup> On the whole, foreign investment didn't figure very prominently in India's economic policy till about mid 1980s. The Indian economic model was based on indigenisation, economic nationalism and self-reliance, developing heavy capital industries and followed by inward looking economic policies. Although this has been critiqued,<sup>192</sup> it is important to understand that given India's colonial past, India's not-so-enthusiastic attitude towards foreign investment wasn't surprising.<sup>193</sup>

India's overall domestic economic policy on foreign investment from 1947 till 1990 provides a useful background to understand India's stand on international investment law during that period. Not just the domestic economic policy based on indigenisation and self-reliance but also India's overall stand on international affairs in the post colonized world contributed to India's position. Internationally, India was keen to build a new international legal order based on equality and sovereignty of nations founded on the spirit of nationalism and economic self-reliance followed domestically. This was reflected in Nehru's speech in the Asian Relations Conference held in March 1947, even before India was formally independent. Nehru said:

*“For too long have we of Asia been petitioners in Western courts and chancelleries. The story must now belong to the past. We propose to stand on our own legs and to co-operate*

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<sup>189</sup> Nayar (2007), 379-380.

<sup>190</sup> Virmani (2003), 3377.

<sup>191</sup> Nagraj (2003), 1701.

<sup>192</sup> See Srinivasan and Tendulkar (2003), 10-19.

<sup>193</sup> Nayar (2007), 379.



*with all others who are prepared to co-operate with us. We do not intend to be the playthings of the others...The countries of Asia can no longer be used as pawns by others; they are bound to have their own policies in world affairs.*"<sup>194</sup>

In his address to the United Nations General Assembly on 3 November 1948, Pandit Nehru said:

*"May I say, as a representative from Asia, that we honour Europe for its culture and for the great advance in human civilization which it represents? May I say that we are equally interested in the solution of European problems; but may I also say that the world is something bigger than Europe, and you will not solve your problems by thinking that the problems of world are mainly European problems. There are vast tracts of the world, which may not in the past, for a few generations, have taken much part in world affairs. But they are awake, their people are moving and they have no intention whatever of being ignored or being passed by."*<sup>195</sup>

India and many other newly independent countries accepted many international law rules, notwithstanding the fact that they had played no role in developing many of these international law standards.<sup>196</sup> However, they objected and challenged certain standards espoused by developed countries such as minimum standard of treatment of aliens and issues pertaining to quantum of compensation in the event of expropriation of foreign investment, in which they had no role to play.<sup>197</sup> India rejected concepts such as 'state responsibility for injuries to aliens' and 'direct individual rights of investors to bring disputes against states under the Convention on the Settlement of Investment Disputes Between States and Individuals of Other States of 1965'<sup>198</sup> (ICSID Convention) and supported United Nations General Assembly Resolutions like 'Declaration of Permanent Sovereignty over natural

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<sup>194</sup> Nehru (1947), 301.

<sup>195</sup> Nehru (1948).

<sup>196</sup> It wasn't the case that India rejected international law in its entirety after independence - Anand (2004), 9-10. However, due to its colonial background, India certainly opposed those principles of international law, which it considered hegemonic in nature not respecting its sovereignty as an independent nation - See Anand (2004), 3.

<sup>197</sup> On this see Anand (2004), 3; Qureshi (2010), 4-5 who states that NIEO 'was a discourse arising from a reaction to the developing country predicament in an international economic system not of their making'. Also see chapters 3 and 4 of the thesis.

<sup>198</sup> The ICSID Convention, The World Bank available at [http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR\\_English-final.pdf](http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf)

resources'.<sup>199</sup> This challenge and rejection was part of a larger effort by India and other newly independent countries to assert themselves in international affairs and play an active role in the making of international law.<sup>200</sup> In 1960s the adoption of the UN General Assembly Resolution declaring permanent sovereignty over natural wealth and resources<sup>201</sup> also indicates the rejection of the law relating to responsibility of states espoused by developed countries.<sup>202</sup>

Nehru's spirit guided India's quest for an international legal order that respected equality and sovereignty of all nations. An integral part of this quest was to build a New International Economic Order (NIEO).<sup>203</sup> India was one of the active supporters of this initiative.<sup>204</sup> The enthusiasm and the active support for the NIEO in India in 1960s and 70s can be gauged from the articles written by Indian government officials and Indian international law academics in India's leading international law journal – The Indian Journal of International Law.<sup>205</sup> India and other developing countries made an effort to evolve a NIEO in 1970s, in the words of an Indian diplomat, as '*a response to a position of political and economic dominance exercised by the metropolitan powers and their nationals over the natural resources, raw materials and labour in developing countries during the colonial era*'.<sup>206</sup> The vision of this NIEO was formulated in the UNCTAD resolution passed in 1972, which '*stressed the urgency to establish generally accepted norms to govern international economic relations systematically and recognised that it is not feasible to establish a joint order and a stable order as long as a*

<sup>199</sup> See, Krishan (2008), 292-293. Also see Roy (1961), 863; Anand (1962).

<sup>200</sup> Anand (1966), 55; Anand (2004) 254.

<sup>201</sup> **General Assembly resolution 1803 (XVII) of 14 December 1962, 'Permanent sovereignty over natural resources' available at <http://www2.ohchr.org/english/law/resources.htm>**

<sup>202</sup> See the arguments of late Professor R P Anand, one of India's prominent international law scholars – Anand (1966) 69. This effort of developing countries like India to challenge existing customary law was challenged by many capital-exporting countries - Anghie (2005), 226-244. A number of theories, aimed to support the interests of foreign investments, like doctrine of state succession and doctrine of acquired rights were used by western scholars to repudiate the position of developing countries like India in support of customary law that had developed when India and many other developing countries were colonies of Europe - Waldock (1962), 49-53. This rule is also reflected in Restatement (Third) of Foreign Relations Law of the United States § 102 (c) Comment d. Also see Gathii (2009), 363-364.

<sup>203</sup> For discussion on NIEO and related developments see Bhagwati (1977); Hossain (1980); Hossain and Chowdhury (1984); Bedjaouti (1979); Rozental (1976), 309; White (1976), 323; Brower and Tepe (1975), 295; Weston (1981), 437; Sornarajah (2010), 122-124; Qureshi (2010), 3; Weiler (2011), 370-377.

<sup>204</sup> Lall (1978), 435. Legal validity of the Declaration by the UN General Assembly in 1974 adopted on NIEO – for a different framework of enquiry to ascertain the legal status see – Khan (1978), 294. For a critical assessment of all the UN General Assembly resolutions adopted as an effort to build the NIEO see – Akinsanya (1978), 183-184.

<sup>205</sup> Jain (1979), 544; Rao (1975), 351; Khan (1978), 294; Agarwala (1977), 261; Shukla (1978), 290.

<sup>206</sup> Rao (2000), 623. Also see Anghie and Chimni (2003), 82.

*charter to protect the rights of all countries, and in particular the developing States, is not formulated*'.<sup>207</sup> This period also witnessed a perpetual effort made by developing countries to influence norms in international law in many fields such as pertaining to monetary law;<sup>208</sup> environment;<sup>209</sup> and multinational corporations.<sup>210</sup>

This effort to build a NIEO was further bolstered by the adoption of the Charter of Economic Rights and Duties of States (CERDS) by the United Nations General Assembly, on 12 December 1974, with 120 countries voting in favour with 6 against<sup>211</sup> and 10 abstentions.<sup>212</sup> India supported CERDS and took active part at every stage in its drafting.<sup>213</sup> The aim of this Charter was to formulate norms related to economic matters having international dimensions benefitting developing countries.<sup>214</sup> The Charter contained provisions recognising the right of countries to regulate foreign investment as per national laws, regulate and supervise the activities of MNCs as per national laws, and decide the question of compensation for expropriation as per national laws.<sup>215</sup> Chimni, a prominent Indian international law scholar, and Anghie describe the developing country scholarship on NIEO in 1970s and 80s as an important formulation of the position taken by the Third World Approaches to International Law (TWAIL) I scholars.<sup>216</sup>

## **2.2 1990s ONWARDS – STORY OF INDIAN ECONOMIC LIBERALISATION**

The Indian economic growth of 1980s (5.7% of annual GDP growth rate as mentioned above) was fuelled by built-up of an external debt that culminated into a severe Balance of Payment (BoP) crisis in 1990-91 with foreign exchange reserves worth only two weeks of imports.<sup>217</sup> In order to overcome this BoP crisis India unleashed major structural adjustments and macro-

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<sup>207</sup> See proceedings of the UN Conference on Trade and Development, Third Session, Vol.1, UN Sales No.E.73.II/D.4.

<sup>208</sup> Resolution on Monetary Reform, U.N.G.A. Res. A/Res/2565(XXIV) of 13 Dec. 1969.

<sup>209</sup> Resolution on Development and Environment, A/Res/2849(XXVI) of 20 Dec. 1971

<sup>210</sup> See Chatterjee (1991), 669-672.

<sup>211</sup> These six countries were Belgium, Denmark, The Federal Republic of Germany, Luxembourg, United Kingdom and United States of America.

<sup>212</sup> The relevant provisions of the Charter are discussed in the chapters on Expropriation and FET.

<sup>213</sup> Rao (1975), 369.

<sup>214</sup> Chatterjee (1991), 669.

<sup>215</sup> See the discussion in expropriation and fair and equitable treatment chapters.

<sup>216</sup> Anghie and Chimni (2003), 82.

<sup>217</sup> See Ahluwalia (2002), 67; Virmani (2003), 3373-3374; Srinivasan and Tendulkar (2003), 1, 9. Also see Nanda (2009) for a different analysis.

economic reforms such as gradually dismantling quantitative restrictions on imports, bringing down tariff rates from a peak of 300 percent to a peak of 35 percent; liberalising FDI and Foreign Institutional Investment (FII) inflows to overcome the problem of over-dependence on debt; and comprehensive reform of the exchange control regime.<sup>218</sup> Many measures aimed at liberalising FDI inflows were adopted in early 1990s marking a change from the cautious receptive attitude to foreign investment of 1980s. These measures included automatic approval of FDI up to 51 percent in high priority industries; 100 percent foreign equity in the energy sector; setting up of a Foreign Investment Promotion Board (FIPB) to act as a single window clearance for foreign investment proposals; opening up new sectors such as mining and telecommunications for private investment including foreign investment; amendment of the foreign exchange regulation act to treat foreign companies with more than 40 percent ownership at par with fully owned Indian companies.<sup>219</sup> These reforms of the external sector signalled a change in India's perception towards foreign investment and a paradigm shift in India's economic thinking. India, slowly but surely, started to move from a close, inward-looking economic model to a liberalised and outward-looking economic model. A major indicator of this paradigm shift was India's acceptance of Article VIII of the International Monetary Fund (IMF) articles on 20 August 1994.<sup>220</sup> Article VIII of IMF Articles provides general obligations of member countries of the IMF including the obligation on avoidance of restrictions on current payments.<sup>221</sup> As a result, India accepted the international obligation not to impose restrictions on current account transactions subject to IMF Articles.

The new industrial policy that India adopted in 1991 recognised that '*foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports*'.<sup>222</sup> In the period from 1992-93 to 1996-97, after the major reforms were introduced, India's GDP grew at an impressive 6.7 percent average.<sup>223</sup> The industrial policy of 1991 allowed investment through two routes – the automatic route (where no permission is needed from the

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<sup>218</sup> For a detailed discussion on these economic reforms see Virmani (2003); Ahluwalia (2002); Rangarajan (2010), 100; Kumar (2005), 1459; Panagariya (2004), 2581.

<sup>219</sup> For more details see Kumar (1998), 1323-1324; Bajpai and Sachs (2001); Nagraj (2003), 1701-1702.

<sup>220</sup> IMF (2011). Also see chapter 5 on monetary transfer provisions.

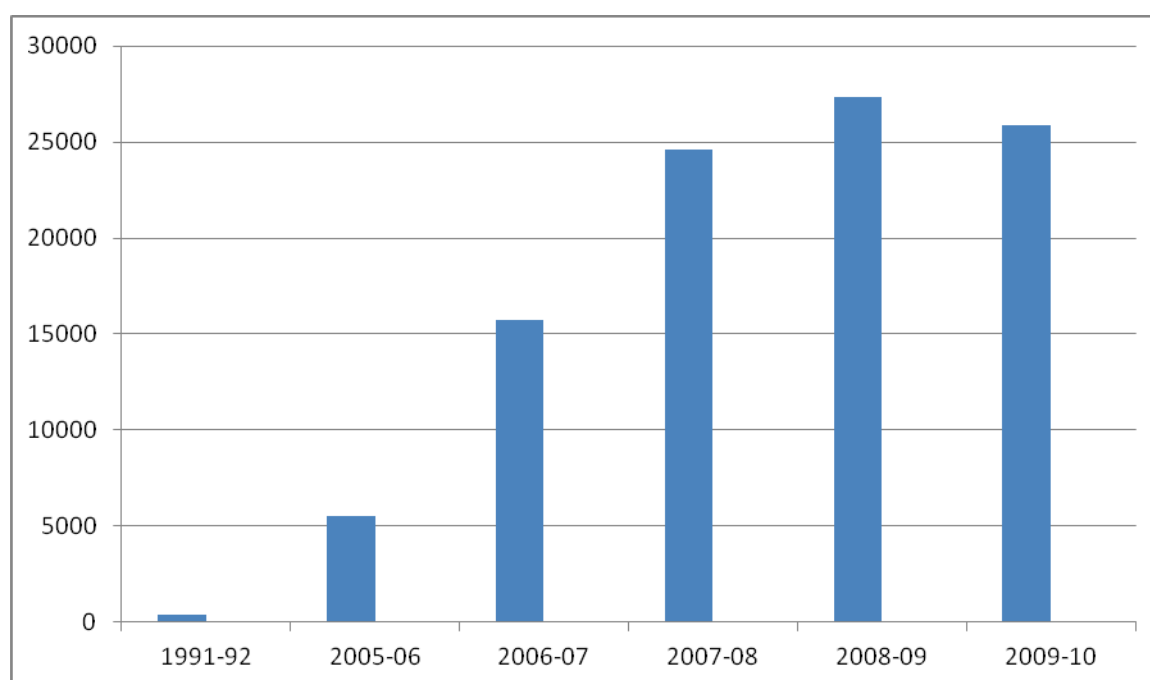
<sup>221</sup> Article VIII (2) of the IMF Articles. Also see the chapter on monetary transfer provisions.

<sup>222</sup> Government of India, Ministry of Industry, Statement on Industrial Policy, available at <http://siadipp.nic.in/publicat/nip0791.htm>. FDI related issues are handled by three main institutions in India – Foreign Investment Promotion Board (FIPB), Foreign Investment Implementation Authority (FIIA – for more on FIIA see <http://dipp.nic.in/English/Investor/FIIA.aspx>) and Secretariat for Industrial Assistance (SIA).

<sup>223</sup> Economic Survey (2001-02).

government) and the approved route (where prior permission of the government is needed). The automatic route has been liberalised over the years as mentioned in the FDI policy of the Indian government released in 2011.<sup>224</sup> The latest industrial policy of the Indian government clearly recognises the central role of foreign investment in India's economic policies.<sup>225</sup> The policy recognises the role of FDI in '*accelerating economic growth*' '*by way of infusion of capital, technology and modern management practices*'.<sup>226</sup> According to the 2011 FDI policy, the intent and objective of India is to attract and promote FDI in order to supplement domestic capital and technology for faster economic growth.<sup>227</sup>

*Chart 1 – FDI Equity Flows to India (in US\$ million) from 1991-92 to 2009-10 (31<sup>st</sup> March 2010)*



*Source – Department of Industrial Policy and Promotion, Ministry of Commerce, India*

<sup>224</sup> Government of India (2011), 31-32.

<sup>225</sup> Industrial Policy, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry available at <http://dipp.nic.in/English/Policies/IndustrialPolicy.pdf>.

<sup>226</sup> Id. Also see Economic Survey (2008-09), which also recognizes the significance of FDI – '*FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy*'.

<sup>227</sup> Department of Industrial Policy and Promotion (2011).

FDI flows to India rose from US \$ 393 million in 1992-93 to US \$ 5549 million in 2005-06.<sup>228</sup> After 2005-06, FDI inflows to India showed a remarkable jump. The FDI equity inflows for the period 2006-07 and 2007-08 stood at US \$ 15726 million<sup>229</sup> and US \$ 24579 million<sup>230</sup> respectively – an increase of almost three and five times respectively from 2005-06. FDI inflows continued their upward movement in the year 2008-09 and stood at US \$ 27309 million.<sup>231</sup> In 2009-10<sup>232</sup>, these inflows only marginally came down to US \$ 25888 million.<sup>233</sup> The FDI equity inflows in the financial year 2011-12 (up to January 2012) stood at US \$ 26192 million.<sup>234</sup>

The sectors of the Indian economy that have received maximum FDI since 1991 are the service sector, electrical equipment (including hardware and software) and the telecommunications sector,<sup>235</sup> automobile, power and the petroleum and natural gas sector.<sup>236</sup> India has opened most of its sectors for foreign investment either fully or partially under the automatic route or the approved route except some sectors like multi brand retail trading, atomic energy, lottery business and gambling and betting.<sup>237</sup>

### 2.3 INDIAN IIAs

Before one starts looking at the reasons behind India entering into IIAs, it is pertinent to have a discussion on the material used for this purpose. There is paucity of material in India on the

<sup>228</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/fdi\\_statistics/india\\_fdi\\_mar06.pdf](http://dipp.nic.in/fdi_statistics/india_fdi_mar06.pdf).

<sup>229</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/fdi\\_statistics/india\\_fdi\\_march2007.pdf](http://dipp.nic.in/fdi_statistics/india_fdi_march2007.pdf).

<sup>230</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/fdi\\_statistics/india\\_fdi\\_March2008.pdf](http://dipp.nic.in/fdi_statistics/india_fdi_March2008.pdf).

<sup>231</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/fdi\\_statistics/india\\_FDI\\_March2009.pdf](http://dipp.nic.in/fdi_statistics/india_FDI_March2009.pdf). In this regard see a recent study that explains this dramatic increase in FDI inflows by focusing on issues surrounding how India defines and calculates FDI and *finds that portfolio investors and round-tripping investments have been important contributors to India’s reported FDI inflows* – Chalapati Rao and Dhar (2011).

<sup>232</sup> This is up to 31<sup>st</sup> March 2010. In India the financial year is from 1<sup>st</sup> April to 31<sup>st</sup> March of the next year. All the references to different years given in the text are from 1<sup>st</sup> April to 31<sup>st</sup> March of the next year.

<sup>233</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/fdi\\_statistics/india\\_FDI\\_March2010.pdf](http://dipp.nic.in/fdi_statistics/india_FDI_March2010.pdf). In this regard, also see the latest study done by the Reserve Bank of India (RBI), which has pointed out that when FDI flows to emerging market economies (EME) recovered during 2010-11, the FDI flows to India remained sluggish – RBI (2012).

<sup>234</sup> Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, India “FDI in India Statistics” available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/2012/india\\_FDI\\_January2012.pdf](http://dipp.nic.in/English/Publications/FDI_Statistics/2012/india_FDI_January2012.pdf)

<sup>235</sup> Bera and Gupta (2009), 11.

<sup>236</sup> Economic Survey (2010-11), WTO (2011).

<sup>237</sup> India (2011).

Indian IIA programme. The researcher, during his visits to the Ministries of Finance; Commerce and Industry; and External Affairs in New Delhi, India couldn't get access to any material that enunciated India's stand on IIAs including the rationale behind India entering into IIAs apart from the various 'compendiums' of Indian IIAs published by the Ministry of Finance and the different press releases issued by the Indian government. To put things in perspective regarding the availability of material on IIAs it is relevant to point out that India's IIAs were not even publicly available on the website of the Ministry of Finance till July-August 2011.<sup>238</sup> It was only towards the later part of 2011 that Ministry of Finance put all the Indian IIAs on the website. Before putting these IIAs on the website, the hard copy of the IIAs were available only if a request was made. Even here, no information was available as to how to make such a request. The researcher learnt about these compendiums in the course of his interactions with the officials of the Ministry of Finance and, as a result, made a request and obtained them for the project at hand.

The researcher's efforts to find out if policy documents on IIAs existed, during his visits to the three ministries, didn't yield much results because in response to each such request, the officials directed the researcher to the compendiums, the website of the Ministry of Finance, and the many press releases issued either by Ministry of Finance or Ministry of Commerce, which give reasons for India entering into IIAs. It appeared that there were actually no policy documents on IIAs rather than the case of something being hidden. This is because IIAs have never been an important issue in Indian policy making for a host of reasons (See section 2.4). An official of the Ministry of Finance mentioned to the researcher that how much priority IIAs occupy directly depends on how much personal interest and motivation the concerned official shows, without there being much institutional mandate to focus on IIAs.<sup>239</sup> The official also mentioned that IIAs do not even take 10 percent of the total professional time of the concerned division of the ministry.

No public documents are available to reveal that studies are or were conducted before launching IIA negotiation with a particular country. There is no publicly available document that could reveal how an assessment was made regarding whether the proposed IIA will benefit India. The only exception to this are the Joint Study Groups (JSG) formed before

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<sup>238</sup> One official of the Ministry of Finance shared with the researcher that the reason behind not putting the IIAs on the website was to ensure that India's negotiating strategy on IIAs is not revealed to other countries!

<sup>239</sup> Interview with one of the six officials of Ministry of Finance.

entering into a Comprehensive Economic Cooperation Agreement (CECA). India has entered into CECAs containing a chapter on investment with Korea,<sup>240</sup> Singapore, Japan and Malaysia (discussion on CECAs appears later in the thesis). These study groups give reports on whether the proposed CECA will increase trade and investment flows between India and its proposed CECA partner. Such JSG reports, then, form the basis for negotiations between India and the other country.<sup>241</sup> The focus of these JSG reports is largely on domestic investment policy issues though they provide some information about India's international investment policy (these are discussed below).

Given the paucity of available material on Indian IIAs, the thesis has used the 'compendiums'; the website of the finance ministry; press releases issued by India subsequent to signing the IIA; information about India's international investment policy given in the JSG reports and the information collected through the interviews with the Indian government officials to find out India's stand on IIAs.

### Indian IIA programme

India started entering into IIAs in early 1990s to attract foreign investments as part of this overall strategy of liberalisation. The Ministry of Finance, Government of India – the nodal body that deals with IIA policy and negotiations clearly states – *'As part of the Economic Reforms Programme initiated in 1991, the foreign investment policy of the Government of India was liberalised and negotiations undertaken with a number of countries to enter into Bilateral Investment Promotion and Protection Agreement (BIPAs) in order to promote and protect on reciprocal basis investment of the investors'*.<sup>242</sup> It also states – *'the objective of Bilateral Investment Promotion and Protection Agreement is to promote and protect the interests of investors of either country in the territory of other country. Such Agreements increase the comfort level of the investors by assuring a minimum standard of treatment in all*

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<sup>240</sup> India Korea CECA (containing the chapter on investment) was signed in 2009 and it became effective from 1<sup>st</sup> January 2010. However, India also has an IIA with Korea signed in 1996. This IIA has not been repealed and hence as of now, both the IIAs (that is the BIT and the investment chapter of CECA) are in existence. This thesis has left out India-Korea IIA of 1996 and has included the investment chapter of CECA as India-Korea IIA. Similarly, the standalone India-Malaysia IIA has been left out and the investment chapter in India-Malaysia CECA has been included.

<sup>241</sup> For different JSG reports see Department of Commerce, Ministry of Commerce, Government of India available at [http://commerce.nic.in/trade/international\\_ta.asp?id=2&trade=i](http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i).

<sup>242</sup> Ministry of Finance (2011). Also see the 'Forewords' written by various Indian Finance Ministers to the Compendiums on BIPAs (New Delhi: Finance Ministry, India, 1996-2011).



*matters and provides for justifiability of disputes with the host country*'.<sup>243</sup> This policy objective is also clearly evident in the 'Forewords' written by different Indian finance ministers from 1994 to 2011 in 'compendiums' of Indian IIAs that the Indian finance ministry regularly publishes. So far, eight such compendiums have been published.<sup>244</sup> In the first such volume (published in 1996-97) Finance minister, P Chidambaram, wrote that after the adoption of liberal economic policies in 1991, India initiated the process of entering into IIAs with a view to provide investor confidence to foreign investors.<sup>245</sup> The same view of India entering into IIAs to protect foreign investment has been repeated in all the subsequent volumes, by different finance ministers belonging to different governments.<sup>246</sup> None of these 'Forewords' talk about the relationship of investment flows with other non-investment issues, nor do they recognise that investment protection should be balanced with other legitimate non-investment objectives. India's commerce minister while answering a question in the Indian Parliament mentioned that India has been entering into IIAs to attract FDI.<sup>247</sup>

The press releases issued by India after entering into IIAs with different countries also reveal that IIAs are primarily about providing protection to foreign investment with the hope that they will increase foreign investment. For example, the press release on India-China IIA states that *'the agreement will increase investment between India and China'*.<sup>248</sup> Similarly, the press release on India-Latvia IIA states that treaty aims at enhancing bilateral investment flows by creating favourable conditions for investors.<sup>249</sup> The same view is echoed in the press release issued on the occasion of signing of the India-Brunei IIA. The press release provides *'the Agreement, which seeks to promote and protect investments from either country in the territory of the other country with the ultimate objective of increasing bilateral investment flow'*...<sup>250</sup> The press release issued on the occasion of the exchange of instruments of ratification of India-Iceland IIA state that the treaty *'seeks to promote and protect investments from either country in the territory of the other country with the objective of increasing*

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<sup>243</sup> Id.

<sup>244</sup> See also Arsanjani and Reisman (2010)

<sup>245</sup> Chidambaram (1997).

<sup>246</sup> See Sinha (1999); Mukherjee (2009).

<sup>247</sup> Sharma (2010).

<sup>248</sup> Bilateral Investment Promotion Agreement with China, Press Release, Press Information Bureau, Government of India available at <http://pib.nic.in/newsite/erelease.aspx?relid=22062>

<sup>249</sup> India-Latvia Signs Bilateral Investment Promotion Agreement, Press Release, Ministry of Commerce and Industry, Government of India available at [http://commerce.nic.in/pressrelease/pressrelease\\_detail.asp?id=2547](http://commerce.nic.in/pressrelease/pressrelease_detail.asp?id=2547)

<sup>250</sup> A Bilateral Investment Promotion and Protection Agreement between the Government of the Republic of India and the Government of His Majesty The Sultan and Yang Di-Pertuan of Brunei Darussalam, Press Release, May 2008, Ministry of Finance, Government of India available at [http://finmin.nic.in/press\\_room/2008/may\\_details.asp?pageid=2](http://finmin.nic.in/press_room/2008/may_details.asp?pageid=2)

*bilateral investment flows.*<sup>251</sup> The Press Release on India-Colombia IIA states that the signing of the treaty is likely to increase to increase investment flow between India and Colombia.<sup>252</sup>

The JSG reports, another important document though restricted to CECAs also gives limited indication on India's international investment policy. The indication is limited because JSGs largely focus on domestic investment regimes of India and the other country involved and do not contain any detailed substantive discussion on any of the international investment law issues. For example, the India-Indonesia JSG, while talking about the proposed investment framework of CECA, mentions about investment protection. Within investment protection, the JSG states that protection should be accorded to all assets of the investor and that there should be adequate provisions relating to free transfers or repatriation of funds.<sup>253</sup> It does not elaborate further on the investment protection features or provisions. Again, the JSG in India-Malaysia does not elaborate on international investment policy barring referring to the India-Malaysia IIA unlike the JSG in India-Indonesia, which does not even refer to India-Indonesia IIA. The JSG states that since CECA envisages a deeper economic engagement between India and Malaysia, a review of IIA would be required '*in order to further enhance investment flows between the two countries*'. There are three important observations about the reference to the India-Malaysia IIA. First, the JSG recognised the need to revisit the IIA in light of CECA negotiations unlike the JSG in India-Indonesia. Second, the JSG recognised that the existing IIA should also contain investment liberalisation provisions (Indian IIAs usually contain investment protection features and not market access provisions – discussed later in the thesis). Third, and most important, the presumption clearly is that IIA between India and Malaysia have increased investment flows and that an IIA containing a more liberal regime will further increase investment flows between the two countries. Similar suggestion to revisit the existing India-Korea IIA is made by the JSG constituted for India-Korea CECA. The JSG states that the India-Korea IIA should be updated in the broader context of a

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<sup>251</sup> India Exchanges Instruments of Ratification on BIPA with Iceland, Press Release, Press Information Bureau, Government of India available at <http://pib.nic.in/newsite/erelease.aspx?relid=45695>. Also see the Press Release on the occasion of India-Jordan IIA, January 2009, available at <http://pib.nic.in/newsite/erelease.aspx?relid=46919>, which also provides the same thing. Also see the Press Release on the occasion of signing of India-Serbia IIA available at [http://pib.nic.in/release/rel\\_print\\_page1.asp?relid=47891](http://pib.nic.in/release/rel_print_page1.asp?relid=47891)

<sup>252</sup> Bilateral Investment Promotion and Protection Agreement with the Republic of Colombia, Press Release, Ministry of Finance, July 2009 available at [http://pib.nic.in/release/rel\\_print\\_page1.asp?relid=49619](http://pib.nic.in/release/rel_print_page1.asp?relid=49619)

<sup>253</sup> Report of the Joint Study Group on the Feasibility of India-Indonesia Comprehensive Economic Cooperation Agreement, 56 available at [http://commerce.nic.in/trade/india\\_indonesia\\_jsg\\_report\\_2009.pdf](http://commerce.nic.in/trade/india_indonesia_jsg_report_2009.pdf).

comprehensive approach of CECA. As per the JSG, this comprehensive approach should include investment protection measures similar to those found in other IIAs.<sup>254</sup>

These documents clearly point to the direction that the object and purpose of Indian IIAs is to attract and protect foreign investment.

India's stand at the WTO during the failed negotiations on an investment agreement where India opposed a multilateral investment agreement on the ground that it will unduly restrain the regulatory power of developing countries<sup>255</sup> is different from the stand taken by India in its IIAs. India, in its submission to the WTO's Working Group on the Relationship between Trade and Investment in 1999, argued that bilateral investment treaties are a better model for developing countries to offer treaty based protection to foreign investment as it allows them to pursue other regulatory interests and thus balance investment protection with country specific sensitivities.<sup>256</sup> The reason for opposing a multilateral agreement on investment in the WTO and supporting bilateral IIAs is the belief amongst Indian policy makers that a multilateral agreement on investment in the WTO will be more demanding due to provisions like pre-entry national treatment protection.<sup>257</sup> However, the thesis will show that even bilateral IIAs have been subject to broad interpretations, which Indian treaty negotiators hadn't envisaged.

As of December 2011, India has entered into IIAs with 86 countries out of which 73 have already come into force.<sup>258</sup> India's latest IIAs that came into force in 2011 are with Bangladesh and Lithuania.<sup>259</sup> India has entered into IIAs with almost all major European countries like UK, France, Germany, Italy, Netherlands, Belgium, Denmark, Poland, Switzerland, Sweden. In fact, India's IIAs in its first five years of the IIA programme (1995-2000) were mainly with European countries in a clear attempt to attract foreign investment. From the year 2000 and after, India entered into IIAs with many developing countries like

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<sup>254</sup> Report of the Joint Study Group on the Feasibility of India-Korea Comprehensive Economic Cooperation Agreement available at <http://commerce.nic.in/India-Korea%20JSG.pdf>

<sup>255</sup> See the Speech of India's Ambassador to the WTO in 2003, 'India's WTO Ambassador Calls for Investment Issue to be Dropped after Cancun', available at <http://www.twinside.org.sg/title/twninfo16.htm>.

<sup>256</sup> India (1999).

<sup>257</sup> This feeling was shared by almost all officials of all ministries interviewed. One official of the Ministry of External Affairs told the researcher that the fact India has not accepted 'pre-entry' national treatment provision has helped India avoid many disputes with foreign investors.

<sup>258</sup> Id. This figure of 73 IIAs includes 69 standalone IIAs and 4 CECAs containing a chapter on investment.

<sup>259</sup> Ministry of Finance, Government of India, Bilateral Investment Promotion and Protection Agreement available at [http://finmin.nic.in/bipa/bipa\\_index.asp?pageid=3](http://finmin.nic.in/bipa/bipa_index.asp?pageid=3).

Argentina, Mexico, China, Thailand, Indonesia, Saudi Arabia as well as with least developed countries (LDCs) like Bangladesh, Sudan, Mozambique.<sup>260</sup> All these IIAs that India has entered into are for a 10-year period and are deemed to be automatically extended after this period unless either State gives notice in writing to terminate the treaty. Further, even if the treaty is terminated, the protection for the existing investments made in India will continue to apply for the next 15 years. So far, India has not terminated any of its IIAs. All IIAs contain investor-state dispute resolution mechanism. Investors can bring disputes against India before international arbitral forums without exhausting the local remedies.

Further, in the last few years, India has entered into CECAs containing a chapter on investment as mentioned above. India is also negotiating CECAs with Indonesia, Australia, Mauritius and New Zealand,<sup>261</sup> is negotiating an IIA with Canada<sup>262</sup> and the US,<sup>263</sup> and a FTA with a chapter on investment with the European Union.<sup>264</sup> CECAs are comprehensive economic agreements (can also be called free trade agreements) covering trade liberalisation (goods and services), investment protection and liberalisation, competition policy, trade facilitation, rules of origin and intellectual property rights. The investment chapters in these CECAs, along with provisions on investment protection; also contain market access provisions (such as national treatment to establishment) which do not exist in any of the existing standalone Indian IIAs. This was affirmed by India's minister of state for finance, who, while answering a question in the Indian parliament on what are the advantages of having investment provisions within the ambit of CECAs, said that investment provisions in CECAs '*aim at providing foreign investors with a level of legal assurance regarding the protection of their investments, as also with specific and transparent commitment on the levels of market access available to them*'.<sup>265</sup> The liberalisation or market access feature of investment chapters in CECAs are different from the standalone IIAs that only deal with

<sup>260</sup> Full list of countries with whom India has entered into an IIA is available at Ministry of Finance, Bilateral Investment and Promotion Agreement (BIPA) - [http://finmin.nic.in/bipa/bipa\\_index.asp?pageid=2](http://finmin.nic.in/bipa/bipa_index.asp?pageid=2)

<sup>261</sup> Department of Commerce, Government of India online: [http://commerce.nic.in/trade/international\\_ta.asp?id=2&trade=i](http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i). India already has an IIA with Indonesia and Mauritius.

<sup>262</sup> "FIPPA will Conclude Soon: Canadian Minister", *MSN* (15 September 2010) online <http://news.in.msn.com/international/article.aspx?cp-documentid=4383002>.

<sup>263</sup> "Negotiations on for India-US Investment Treaty: Pranab", *NDTV Profit* (8 November 2010) online NDTV Profit <http://profit.ndtv.com/news/show/negotiations-on-for-india-us-investment-treaty-pranab-118535>.

<sup>264</sup> "India-EU Hope to Conclude FTA soon", *The Indian Express* (15 October 2010), online *The Indian Express* <http://www.indianexpress.com/news/india-eu-hope-to-conclude-fta-soon/692460/>. Also see the Economic Survey of 2011-12 that gives information about the ongoing negotiations on these CECAs – Economic Survey (2011-12), 176-177.

<sup>265</sup> Rajya Sabha, Unstarred Question Number 2615 available at <http://164.100.47.5:8080/members/website/quest.asp?qref=153265>

post-establishment phase. There are many other substantial differences between the two types of IIAs, as will be discussed throughout the thesis. The provisions of the investment chapters in CECAs are much more elaborate and contain more features aimed at protecting the exercise of India's regulatory power. For example – investment chapter in Singapore CECA does not contain the FET provision whereas FET is part of almost all Indian IIAs. Thus, India's IIA programme stands on two legs – standalone bilateral IIAs and investment chapters in bilateral CECAs - in this thesis collectively called IIAs.

The figures on FDI inflows and number of IIAs entered by India show that the Indian economy is fast integrating with the global economy, which in turn is increasing the interactions between the Indian state and foreign investors. This is capable of creating situations of conflicts between investment protection and regulation. Given below are some key examples of these conflicts seen in recent times.

### 2.3.1 Conflicts between Investment Protection and Regulation

There have been many instances of different organs of the Indian state and foreign corporations coming face to face on regulatory issues. Some of these regulatory conflicts have taken the shape of ITA arbitration. Very recently, in some cases, notice to commence ITA arbitration against India has been served by foreign corporations. These examples are important to show that, as India integrates with the global economy, conflicts will arise while regulating foreign investment. Hence, these examples further necessitate the need to study Indian IIAs in detail from the perspective of India's regulatory power. Another important issue that emerges from these cases is that different organs of the state appear to be oblivious to India's international obligations owed to foreign investors under IIAs.<sup>266</sup>

#### *Dabhol Power project case*

This relates to an FDI project related to building an electrical power plant in India in early 1990s soon after the adoption of the liberalisation programme by India in 1991. Enron Corporation along with General Electric (GE) Corporation and Bechtel Enterprises formed a company called Dabhol Power Company (DPC) in Maharashtra (a western Indian state) to

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<sup>266</sup> Ranjan (2012).

generate electrical power. This formed the biggest FDI investment at that time in India. DPC entered into an agreement with the Maharashtra State Electricity Board (MSEB) a public sector enterprise as the sole purchaser of the power generated by DPC. Subsequently, due to political opposition to the project on grounds of alleged irregularities and the high cost of power charged by DPC, MSEB cancelled the contract to purchase power leaving DPC without a consumer to sell electrical power and thus having a huge adverse impact on DPC's business.<sup>267</sup> Further, the central government of India, which acted as a counter guarantor, after making some payments, also declined to pay DPC for different reasons.<sup>268</sup> DPC was restrained from starting an international arbitration by anti-arbitration injunctions issued by Indian courts.<sup>269</sup> There is no evidence to show that either the state government of Maharashtra or the central government of India or the Judiciary took India's IIAs into account while exercising their regulatory powers.

The Mauritius based subsidiaries of GE and Bechtel, relying on the India-Mauritius IIA, challenged India's regulatory decisions including sovereign functions like issuing anti-arbitration injunctions by courts as violation of the IIA provisions like expropriation. However, before an ITA award could be issued a mutual settlement was reached<sup>270</sup> whereby a mammoth compensation (according to some - US \$ 1 billion)<sup>271</sup> was awarded to foreign investors by India. The significance of this case is in illustrating how India's exercise of regulatory powers (which includes the Indian judiciary) has the potential to violate the broad IIA provisions.

#### *Australian mining company IIA dispute*

White Industries, an Australian company, obtained an arbitral award in its favour in a contractual dispute with Coal India, an Indian public sector company, and sought enforcement of the award before the Delhi High Court in India. Simultaneously, Coal India approached the Calcutta High Court to have the award set aside, and the request was granted. White Industries appealed to the Supreme Court in 2004 and the final decision is still

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<sup>267</sup> For detailed facts of the case see – Kundra (2008), 908.

<sup>268</sup> Id.

<sup>269</sup> Id.

<sup>270</sup> "GE settles Dabhol Issue" The Indian Express (3 July 2005) online: <http://www.indianexpress.com/oldStory/73760/>.

<sup>271</sup> Ghosh (2010).

pending. In 2010, White Industries took the matter to ITA on the grounds that the inordinate delay in Indian courts to enforce the arbitration award violates the India-Australia IIA.<sup>272</sup> The tribunal held that this delay by Indian courts violated India's obligation to provide White industries with an 'effective means' of asserting claims and enforcing rights, despite the fact that the India-Australia BIT does not mention or include such a duty for host states. The tribunal got around that by holding that White Industries could borrow the 'effective means' provision present in the India-Kuwait IIA<sup>273</sup> by relying on the MFN provision of the India-Australia IIA.<sup>274</sup>

### *Cancellation of Telecom Licenses*

This case relates to the grant of Unified Access Service License (UAS) with 2 G spectrum to telecom companies both Indian and of foreign origin by the Indian government. These telecom licenses were granted following the first-come-first-serve policy. However, a writ petition was filed in the Supreme Court of India arguing that the grant of these licenses was arbitrary and unconstitutional. The Supreme Court of India held that indeed the licenses granted by the Indian government were 'arbitrary and unconstitutional' and hence all the licenses were illegal and thus quashed.<sup>275</sup> The cancellation of these telecom licenses will adversely affect the investment of many foreign companies. Sistema, a Russian firm, whose licenses have been cancelled by the Supreme Court of India, has served a notice to India to commence ITA proceedings under the India-Russia IIA.<sup>276</sup> Similarly, Telenor, another company whose telecom licenses have been cancelled is contemplating to invoke India-Singapore IIA against India.<sup>277</sup> Also, important to note that the Supreme Court of India, in its verdict, didn't discuss its legal arguments in view of obligations that India owes to foreign investors under IIAs.

<sup>272</sup> White Industries Australia Limited v The Republic of India, Final Award, UNCITRAL, 30 November 2011.

<sup>273</sup> Article 4(5) of the India-Kuwait BIT provides that '*each contracting party shall...provide effective means of asserting claims and enforcing rights with respect to investments...*'.

<sup>274</sup> Article 4(2) of the India-Australia BIT provides the MFN provision according to which, '*a contracting party shall at all times treat investments in its territory on a basis no less favourable than that accorded to investments or investors of any third country*'.

<sup>275</sup> *Centre for Public Interest Litigation and Others v Union of India and others*, Writ Petition Civil No 423 of 2010, In the Supreme Court of India.

<sup>276</sup> Fix Dispute in Six Months or Face Arbitration, Sistema tells India, The Financial Express, 29 February 2012 available at <http://www.financialexpress.com/news/fix-dispute-in-6-months-or-face-arbitration-sistema-tells-india/918076/0>

<sup>277</sup> 2G Mess: Telenor May Invoke India-Singapore Bilateral Pact, The Hindu Business Line, March 2012 available at <http://www.thehindubusinessline.com/industry-and-economy/info-tech/article3155481.ece>



## *Vodafone BV tax dispute*

This relates to the case involving imposition of capital gains tax on a US \$ 11.2 billion transaction where Vodafone BV International (Vodafone's Netherland entity) in December 2006 entered into an agreement with Hutchison Telecommunications International Ltd (HTIL – a Cayman Island company) to buy HTIL's share of 67 percent interest in an Indian company Hutchison Essar Ltd (HEL).<sup>278</sup> Vodafone BV contended that the transactions did not involve a capital asset situated in India and hence no capital gains tax was payable whereas the Indian tax authorities contended otherwise. The Bombay High Court decided the case against Vodafone BV in 2010.<sup>279</sup> However, the Supreme Court of India reversed the Bombay High Court ruling and held that Vodafone didn't owe any tax to the Indian government.<sup>280</sup> Subsequently, the Indian government has proposed to insert an explanation in the Indian Income Tax Act, which will make such transactions taxable with retrospective effect.<sup>281</sup> Further, the Indian government has also proposed a clause, which provides for validation of tax demands including that on capital gains raised on companies registered outside India irrespective of any court judgment.<sup>282</sup> Both these clauses are clearly directed at taxing Vodafone despite the Supreme Court's ruling in favour of Vodafone. In response to this, Vodafone has issued a notice to India to start treaty-arbitration under the India-Netherlands IIA.<sup>283</sup> In fact, the proposal to impose retrospective taxation may adversely affect many more foreign corporations operating in India like US-based *GE*, UK-based *SABMiller*, *Mitsui* of Japan and French drug-maker *Sanofi Aventis*.<sup>284</sup> Again, the Indian executive has not examined the compatibility of these new regulatory measures in light of obligations India owes to Vodafone under the India-Netherlands IIA or to other foreign investors under different IIAs.

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<sup>278</sup> "The Vodafone Tax Dispute – A Landmark Judgment of the Bombay High Court" (November 2010) online <http://www.bcasonline.org/articles/artin.asp?961>.

<sup>279</sup> *Vodafone International Holdings B.V. v Union of India*, Writ Petition No. 1323 of 2010.

<sup>280</sup> *Vodafone International Holdings BV v Union of India*, Civil Appeal No 733 of 2012, In the Supreme Court of India. For more information related to the application of the Indian tax law on Vodafone BV see Kumkum Sen "Vodafone Ruling: A Step Back in Investor Relations" *Business Standard* (13 September 2010) online <http://www.business-standard.com/india/news/vodafone-rulingstep-back-in-investor-relations/407859/>

<sup>281</sup> See Clause 4, Explanation 5 of the Finance Bill 2012 aimed at amending the Indian Income Tax Act available at <http://indiabudget.nic.in/ub2012-13/fb/bill31.pdf>

<sup>282</sup> See Clause 113 of the Finance Bill 2012 available at <http://indiabudget.nic.in/ub2012-13/fb/bill32.pdf>

<sup>283</sup> Vodafone Serves India Notice on Proposal to Tax Overseas Deals available at <http://www.indianexpress.com/news/vodafone-serves-india-notice-on-proposal-to-tax-overseas-deals/937899/0>

<sup>284</sup> Not Just Vodafone, Taxman Could Dig Up these Deals Too available at <http://www.indianexpress.com/news/not-just-vodafone-taxman-could-dig-up-these-deals-too/925789/0>



### *Cairn-Vedanta deal*

Cairn Energy, a UK company, struck a deal with London based Vedanta resources to sell majority stake in its Indian unit (Cairn India) in August 2010. However, this deal required the approval of the Indian government as per Cairn's existing contractual obligations. After prolonged delay, in June 2011, the Indian government gave conditional approval to the deal.<sup>285</sup> The conditions imposed by the Indian government are - make royalty paid as cost recoverable from oil sales and for Cairn to withdraw the cess arbitration it has initiated.<sup>286</sup>

### *Posco's Investment and Environment*

South Korean company, Posco, plans to invest US \$ 12 billion in India for constructing a steel plant. The efforts in this direction were initiated by Posco in 2005-06. After prolonged delay, India's Environment ministry gave an environmental clearance to the project in 2011. The environment ministry didn't take into account the India-Korea IIA while exercising its regulatory power to grant environmental clearance to the project.<sup>287</sup> However, some environmental activists challenged this in the National Green Tribunal (NGT). On 31 March 2012, the NGT revoked the environmental clearance given to Posco.<sup>288</sup> One is unsure whether India-Korea IIA figured in the legal analysis of NGT in revoking the environmental clearance to Posco. The revocation of the environmental clearance has jeopardised Posco's investments in India.

### 2.3.2 Overview of the Key Features of Indian IIAs

Before the thesis dwells on the four substantive provisions mentioned above, it is useful to provide a brief overview of how the key features in Indian IIAs are formulated.

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<sup>285</sup> "Cairn-Vedanta Deal Riders Upset Global Investors", Business Standard (July 2011) online: <http://business-standard.com/india/news/cairn-vedanta-deal-riders-upset-global-investors/441272/>.

<sup>286</sup> Id.

<sup>287</sup> Ranjan (2010).

<sup>288</sup> Tribunal Puts Posco Green Signal on Hold available at <http://www.indianexpress.com/news/tribunal-puts-posco-green-signal-on-hold/930792/>

### *Definition of Investment*

Out of the 73 IIAs studied, as many as 72 (except India-Mexico) of them contain a broad asset-based definition of investment. In these 72 IIAs, it is stated that investment means every kind of asset. This broad definition is then followed by an inclusive or non-exhaustive list of assets, which includes direct investment, portfolio investment, intellectual property rights, rights to money or to any performance under contract having a financial value, business concessions conferred under law or contract. Out of these 72 IIAs that provide a broad asset-based definition of investment, only three IIAs - India-Korea; India-Malaysia and India-Japan - state that in addition to investment being every kind of asset that the investor owns or controls, it should have the characteristics of an investment like commitment of capital or other resources, the expectation of gains or profits or the assumption of risk.

The definition of investment in all these IIAs is subject to national laws. This gives regulatory power to India to refuse treaty protection to those investments that have been made in contravention of the Indian law or which are illegal under Indian law.

### *Promotion and Protection of Investment*

All Indian IIAs including the Indian model IIA provide in the text that investment promotion is an important objective of the IIA and that India will take steps towards creating suitable conditions for fostering investment. The Indian model IIA states that each contracting party ‘*shall encourage and create favourable conditions for investors of the other Contracting Party to make investments in its territory*’.

### *Full Protection and Security*

‘Full protection and security’ is a feature in 38 Indian IIAs. India-Latvia IIA only states ‘protection and security’ not qualified by ‘full’.<sup>289</sup> None of these IIAs explain what is meant by ‘full protection and security’. The only exceptions to this are India-Korea, India-Malaysia and India-Japan IIAs, which provide some indication regarding the meaning of ‘full protection and security’. These three IIAs link ‘full protection and security’ with customary

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<sup>289</sup> Article 3(3) of the India Latvia IIA.

international law. For example, Article 87.1 of the India-Japan IIA states – *The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.*<sup>290</sup> In the rest 35 Indian IIAs it is unclear whether ‘full protection and security’ means protecting and securing foreign investment from physical injury or does it also involve protection from non-physical injury.<sup>291</sup>

### *Fair and Equitable treatment*

A study of 73 Indian IIAs reveals that as many as 71 Indian IIAs contain the FET principle. Out of these, 66 do not define the normative content of the FET or provide any guidance regarding its meaning, thus leaving the determination of FET content to arbitral discretion. Only in 5 IIAs a reference is made to the minimum standard of treatment of aliens under customary international law.<sup>292</sup>

### *Most Favoured Nation and National treatment*

Barring two IIAs, all Indian IIAs contain the MFN principle. This principle is worded broadly, making it possible for foreign investors to borrow beneficial treaty provisions from other treaties.<sup>293</sup> The only exception recognised to the MFN principle is for the purposes of

<sup>290</sup> Similar provision occurs in Article 10.5(2) of the India-Malaysia IIA and Article 10.4(1) of the India-Korea IIA. These are same as the NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, 31 July 2011. Compare these provisions with a more specific provision of the kind found in US-Uruguay IIA – Article 5(2)(B), which states full protection and security requires each country to provide the level of police protection required under customary international law.

<sup>291</sup> In earlier investment treaty arbitration cases such as *AAPL v Sri Lanka* ICSID Case No ARB/87/3 (Final Award) 27 June 1990 and *AMT v Zaire* ICSID Case No ARB/93/1 (Award) 21 February 1997<sup>291</sup> the understanding of ‘full protection and security’ was confined to physical safety and protection of investments. However, subsequent tribunals have expanded the meaning of ‘full protection and security’ from physical protection to also include regulatory and legal security - Newcombe and Paradell (2009), 310. For example, in *CME v Czech Republic*, the tribunal while analysing the obligation of ‘full security and protection’ held that ‘the host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued’ - *CME* tribunal, para 613. Also see *Azurix v Argentina*, paras 406-408; *Siemens v Argentina*, para 303. This view goes beyond the traditional understanding based on customary international law and advocates for an autonomous interpretation of the standard. On the other hand, some recent arbitral awards like *AWG v Argentina* have held that ‘full protection and security’ is limited to protection from physical injury and does not encompass the maintenance of stable and legal commercial or business environment - *AWG v Argentina*, para 179. Also see *Saluka v Czech Republic*, para 484; *BG v Argentina*, paras 323-326.

<sup>292</sup> See chapter 4 on FET for more details.

<sup>293</sup> *Maffezini v. Spain* (ICSID Case No. ARB/97/7); *MTD v. Chile* (ICSID Case No. ARB/01/7); *Bayindir Insaat v. Pakistan* (ICSID Case No. ARB/03/29).

taxation and obligations imposed by free trade agreements or custom areas. Similarly, national treatment protection to foreign investment is offered in broad manner. Barring a few IIAs like the India-Mexico IIA, the national treatment provisions in the majority of Indian IIAs do not contain the ‘like circumstances’ clause, which requires that in order to find out whether national treatment has been provided or not, only investments in ‘like circumstances’ need to be compared. This arguably broadens the national treatment protection to foreign investments. Further, barring IIAs with Japan, Korea, Singapore and Malaysia, none of the Indian IIAs provide sector specific exceptions to the principle of national treatment.

### *Expropriation*

All the 73 Indian IIAs contain provisions on expropriation very clearly stating that investment shall not be nationalised or expropriated (direct expropriation) or subjected to measures having ‘effect’ equivalent to expropriation (indirect expropriation) unless or until there is a public purpose, and further that in such cases fair and equitable compensation should be promptly paid to foreign investors.<sup>294</sup>

### *Monetary Transfer Provision (MTP)*

All 73 Indian IIAs studied contain a MTP. In majority of IIAs the provision on monetary transfer is broadly worded and does not recognize exceptions to transfer of funds across borders.<sup>295</sup>

### *Treaty Exceptions*

Examination of 73 Indian IIAs reveals that in more than 60 IIAs exceptions to treaty obligations are very narrowly formulated. Very few IIAs allow deviation from investment protection on potentially very significant grounds such as ‘public order’, ‘health’ or

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<sup>294</sup> For full details look at chapter 3 on expropriation.

<sup>295</sup> See chapter 5 on MTPs

‘environment’ or on grounds such as ‘to boost certain domestic industries’ or ‘domestic industries in economically backward regions’.<sup>296</sup>

### *Title of the IIAs*

The study of 73 Indian IIAs shows that, barring four, all IIAs only have the following words in their title: ‘promotion and protection’ of investment. The only slight variation is that some IIAs like India-Kuwait and India-Saudi Arabia use words like ‘encouragement’ instead of ‘promotion’, which means the same thing. Thus, according to the title of 69 IIAs, all these treaties are ‘*An Agreement for the promotion and protection of investments*’.<sup>297</sup> Only the IIAs with Singapore, Korea, Japan and Malaysia have a different title - ‘comprehensive economic cooperation/partnership agreement’. ‘Economic cooperation or partnership’ is broader than ‘investment protection and promotion’.

### *Preamble*

The preamble of an IIA is important to determine its object and purpose.<sup>298</sup> The preamble of the Indian Model IIA states the following objectives:

- a. Desiring to create conditions favourable for fostering greater investment by investors of one State in the territory of the other State;

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<sup>296</sup> Muchlinski (2008), 23. India-Korea IIA is one such example, which states: ‘India reserves the right to adopt or maintain any measure that accords rights or preferences to economically backward regions or groups in the interest of balanced development of the economy and maintenance of social equality’ – as an exception to national treatment. Also see chapter 6 on NPM.

<sup>297</sup> The title of the IIA can be one important indicator of the object and purpose of the IIA - Gardiner (2008), 180-181. For example, the tribunal in *Plama v. Bulgaria* ICSID Case No ARB/03/24, 8 February 2005 deduced the object and purpose of the IIA by referring to the preamble and also the title of the IIA, which referred to ‘mutual encouragement and protection of investments’ - *Plama v. Bulgaria*, para 193. The tribunal, after determining that the object and purpose of the IIA is to promote and protect investment, said: ‘*It is legitimate to resolve uncertainties in its interpretation [provision on “umbrella clause”] so as to favour the protection of covered investments*’ – para 193. Similarly, in *SGS SA v. Philippines* ICSID Case No. ARB/02/6 29 January 2004, the tribunal in finding out the object and purpose said that ‘the BIT is a treaty for the promotion and mutual protection of investments’- para 116.

<sup>298</sup> See, for example, Dolzer & Schreuer (2008: 32). *Siemens A.G. v. Argentina*, (decision on jurisdiction, 3 August 2004), paras 80-81; *CMS v. Argentina*, para. 274; *Eureko v. Poland* (Partial Award, 19 August 2005); *Azurix Corp v. Argentina* (Award, 14 July 2006, para. 307); *Saluka v. Czech Republic* (Partial Award, 17 March 2006 under UNCITRAL rules, paras 299-300); *Enron v. Argentina*, paras 331 and 332; also see discussion in *Continental v. Argentina*, para. 258.

- b. Recognising that the encouragement and reciprocal protection under International agreement of such investment will be conducive to the stimulation of individual business initiative and will increase prosperity in both States;

An identical preamble is to be found in as many as 48 Indian IIAs out of the 73 studied. Of the remaining 25 IIAs, four of them, barring a difference of a few words in the formulation, contain the same preamble as the model IIA discussed above. Further, there are three IIAs that apart from the investment promotion objectives also recognise that FET regarding investment will help in fostering investment and in intensifying cooperation between the enterprises of the two countries. Thus providing FET to investment is clearly identified as one of the objectives of the IIA in the preamble.<sup>299</sup>

The preambles of Indian IIAs focus on creating conditions favourable for encouraging investment flows; and recognising that encouragement and protection of investment will stimulate business activity and increase prosperity. Thus, ‘stimulating business initiative’ and ‘increase in prosperity’ in both the countries are not self-standing objectives, but are linked to encouragement and protection of investment.<sup>300</sup>

Very few Indian IIAs contain more values in the Preamble apart from investment promotion and protection. For example, India-Singapore, India-Korea, India-Malaysia and India-Japan treaties refer to multiple values such as ‘rights to pursue economic philosophies suited to their development goals’; ‘rights to realise their national policy objectives’; and ‘optimal use of natural resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment’.<sup>301</sup> On similar lines, the preamble in the India-

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<sup>299</sup> Tribunals have relied on the presence of FET in the preamble to interpret FET as a treaty provision giving precedence to investment protection -

<sup>300</sup> In this context, see also Alvarez & Khamisi (2009), 470 where the argument on the preamble in the US-Argentina IIA is that ‘greater economic cooperation’ and ‘economic development’ are not self-standing goals in the preamble but possible outcomes of protecting foreign investment, which is the object and purpose. Also compare this with the Preamble to the Marrakesh Agreement Establishing the World Trade Organization, available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/wto\\_agree\\_01\\_e.htm](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/wto_agree_01_e.htm). This preamble provides that trade relations between countries should be conducted, among other things, in accordance with the objective of sustainable development. Further, it recognizes as a self standing goal the need to take efforts to ensure that developing countries and lesser developed countries (LDCs) secure a share in the growth of international trade, which is proportionate with their economic development needs – also see *United States-Import Prohibition of Certain Shrimp and Shrimp Products, Report of the Appellate Body, WT/DS58/AB/R, 12 October 1998*, which took cognizance of the preamble to the WTO agreement to adopt a more balanced interpretation of the GATT provision.

<sup>301</sup> The preamble in these four agreements is for the entire treaty and not just the investment chapter. More generally on ‘development’ in the context of investment treaty arbitration, see the Malaysian Sahors case.

Australia IIA provides that ‘investment relations should be promoted and economic relations strengthened in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence’.

A combined reading of the title of Indian IIAs, their preambles and substantive protections, which are worded in broad terms, one can state that the object and purpose of Indian IIAs is limited to investment protection, which, in turn, is expected to result in more investment flows.<sup>302</sup> Due emphasis on object and purpose is an integral part of treaty interpretation methodology warranted by Article 31 of the VCLT and thus cannot be ignored.<sup>303</sup>

## **2.4 INDIA AND GLOBAL DEBATE**

Notwithstanding the global debate on whether IIAs encroach upon the host state’s ability to exercise regulatory power, in India, IIAs are still seen primarily as instruments aimed at promoting and protecting investment. Their relationship with regulatory power has not yet been fully realised and understood. Further, despite a massive IIA programme resulting in international obligations, Indian IIAs as such, have hardly been an issue in academic and policy debates within India, although foreign investment policies have certainly attracted attention.<sup>304</sup>

There are two reasons for this. First, lack of adequate information and awareness and lack of rigorous academic analysis or commentary about the full implications of IIAs on regulatory power in India due to general lack of legal expertise in the field of international investment law. There have been very few occasions where India’s IIAs have been comprehensively discussed in academic conferences and policy circles with one notable exception being the fourth forum for developing country investment negotiators organised in New Delhi in

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<sup>302</sup> In this regard, it is also important to mention the cautionary note given in *Plama v. Bulgaria*, where the tribunal (quoting Sir Ian Sinclair) said: *risk that the placing of undue emphasis on the ‘object and purpose’ of a treaty will encourage teleological methods of interpretation [which], in some of its more extreme forms, will even deny the relevance of the intentions of the parties - Plama Consortium v. Bulgaria*, referring to Sinclair (1984: 130). See also Salacuse (2010: 146-148).

<sup>303</sup> Shaw (2008), 933. In this regard also see McLachlan (2008) 371; Kurtz (2010: 351); and *Saluka v. Czech Republic*, para. 300. Also see Gardiner (2008), 197

<sup>304</sup> Similar arguments have also been made in context of China. It has been argued that while China has changed many of its laws due to WTO obligations, the Chinese BITs have not received equal attention – G Wang (2009), *China’s Practice in International Investment Law: From Participation to Leadership in World Economy*, 34 *Yale Journal of International Law*, 575 at 585-586.

October 2010. Similarly, there has been only one occasion where a question was asked to the government in the Indian Parliament on whether India has entered into IIAs and what is the advantage of having investment provisions in CECAs.<sup>305</sup> Also, since IIAs have not resulted in legislative changes, they are not discussed in the Parliament of India. In India, treaties are ratified by the Executive and not by the Parliament of India and hence discussion on a treaty takes place only when a legislative change is introduced by the Executive in the Parliament in order to meet the obligation imposed by the international treaty. This is not to suggest that the Parliament cannot discuss the significance of IIAs if it so desires; however it has not done so far mainly because it is oblivious of the significance of IIAs. This is in contrast to the WTO agreements, which have been discussed in the Indian parliament especially during the legislative changes to be made due to its obligations.<sup>306</sup> WTO agreements have also attracted considerable discussion in academic and policy conferences. There are a number of policy think-tanks as well as civil society organisations in India working on WTO issues whose research and advocacy has sensitised and built capacity of many stakeholders including the government and the Parliament to understand complex trade issues.<sup>307</sup> However, IIAs do not figure highly on the research agenda of these think-tanks although work on the economic and developmental dimensions of foreign investment do get attention.

Second, barring the *White Industries* ITA arbitral award, Indian IIAs have not generated much arbitral jurisprudence. Hence, import of most of the IIAs signed by India remains untested and hence unclear to policy makers. The lack of arbitral jurisprudence on Indian IIAs, coupled with lack of detailed commentary on Indian IIAs, has generated the official mindset that there is no need to think about IIAs impact on regulatory power till India gets hit by claims, despite what has happened to other developing countries.<sup>308</sup> In fact, many officials

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<sup>305</sup> Question asked by P K Javedkar, Member of Parliament in Rajya Sabha, on Bilateral Investment Treaties (BITs), Unstarred Question No 2615, 20 April 2010 available at <http://164.100.47.5:8080/members/website/quest.asp?qref=153265>.

<sup>306</sup> For example, the provisions of the TRIPS agreement got attention of the Parliament when India was debating amendments to its Patent Act of 1970 due to the WTO obligations. Even in the context of these obligations it has been argued that there is a need to expand the role of Parliament from not just debating how the treaty provisions already accepted and ratified by the Executive should be transformed into domestic laws, but also to decide whether India should accept the international treaty obligations in the first place at all – See Saxena (2007), 24; National Commission to Review the Working of the Constitution (2002); Krishna Iyer (2003), 10; Dhar and Kallummal (2007), 183; Ranjan (2009), 56.

<sup>307</sup> Some of the prominent think-tanks and civil society organisations working on WTO issues in India are Centre for WTO Studies <http://wtocentre.iift.ac.in/>; Indian Council for Research in International Economic Relations (ICRIER) <http://www.icrier.org/>; Research and Information System for Developing Countries <http://www.ris.org.in/>; CUTS International <http://www.cuts-international.org/>.

<sup>308</sup> All six officials of Ministry of Finance were of this view. Only some officials of Ministry of External Affairs admitted that the fact that India has not been hit by a claim cannot be the basis for any complacency or belief



were surprised on hearing that there could be such a strong link between IIAs and the exercise of India's regulatory power. This belief and mindset are further strengthened by the lack of adequate understanding about the actual impact and working of IIAs across different central government departments.<sup>309</sup> An insight into how India negotiates its IIAs will be useful at this stage to substantiate this point.

#### 2.4.1 How India Negotiates IIAs

The Ministry of Finance of the Government of India is the nodal body for all IIA negotiations and also for developing policies related to the IIA, barring those where the investment chapter is a part of CECAs. CECAs containing investment chapters are dealt by the Trade and Policy division (TPD) of the Ministry of Commerce.<sup>310</sup> In other words, Ministry of Finance deals with standalone IIAs, whereas, when same investment obligations have to be undertaken as part of a free trade agreement, then Ministry of Commerce is in control.

Ministry of Finance is divided into five different departments – namely economic affairs, expenditure, revenue, financial services and disinvestment.<sup>311</sup> The Department of Economic Affairs (DEA) deals with IIAs. This Department is further divided into different divisions.<sup>312</sup> One of the divisions of DEA is 'Infrastructure and Investment Division'.<sup>313</sup> The section on 'International Cooperation' (IC) within this division deals with '*negotiation and conclusion of Bilateral Investment Promotion and Protection Agreements (BIPAs) with other countries*'.<sup>314</sup> 'The IC section has an official of the rank of Director who looks after all the major functions of the section including all issues pertaining to IIAs. This official is not a

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that all is well with India's IIAs. Poulsen's study corroborates this point for many developing countries – See Poulsen (2011), 216-256. Also see Poulsen and Aisbett (2011).

<sup>309</sup> The very recent *White Industries* arbitration case and the recent arbitration notices issued by foreign corporation under different IIAs has led to some mulling over Indian IIAs within the Indian government. Though its outcome, and whether this would lead to a paradigm change in how India deals with IIAs is yet to be ascertained.

<sup>310</sup> Trade Policy Division, Department of Commerce, Ministry of Commerce and Industry, Government of India available at [http://commerce.nic.in/aboutus/aboutus\\_rti\\_divisions\\_itpd\\_1.asp](http://commerce.nic.in/aboutus/aboutus_rti_divisions_itpd_1.asp)

<sup>311</sup> About the Finance Ministry available at <http://finmin.nic.in/index.asp>.

<sup>312</sup> Department of Economic Affairs available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/dea\\_mainpage.asp](http://finmin.nic.in/the_ministry/dept_eco_affairs/dea_mainpage.asp).

<sup>313</sup> Infrastructure and Investment Division available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/infrastructure\\_div/I&I\\_index.asp](http://finmin.nic.in/the_ministry/dept_eco_affairs/infrastructure_div/I&I_index.asp).

<sup>314</sup> Id. Also see Major Functions of the International Cooperation section available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/icsection/icsec\\_index.asp](http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/icsec_index.asp).

professional lawyer or an economist but belongs to the Indian Civil Services<sup>315</sup> and need not necessarily be trained in either subject or international affairs. Further, this official joins the IC section on a transferable basis and moves to another department, or ministry, on promotion.

This official reports to the Joint Secretary of the ‘Infrastructure and Investment Division’ who is also not a professional economist or lawyer, but belongs to the generalist Indian Civil Services and serves the division on a transferable basis for a limited duration. For example, more than three different officials have held the position of the Joint Secretary (Infrastructure and Investment Division) in Ministry of Finance in last three years or so. This position is the most important position in the Ministry of Finance for work related to IIAs (See section 2.4.1 on this).<sup>316</sup> In fact, it is interesting to note that the IC section has no full-time trained and qualified lawyers or economists or experts in international affairs. The entire section is staffed by generalists belonging to the larger pool of Indian bureaucracy. This often results in a lack of capacity to understand complex issues related to IIAs leading to other attendant problems. Further, even if a new official develops the expertise by working in the division, this capacity is lost when the official is transferred to another division or department or ministry and the new official often has to start from scratch. Officials admit that their generalist background devoid of any professional background in law and economics often makes it extremely difficult for them to grapple with complex issues related to international investment law and policy.<sup>317</sup> This lack of technical expertise is also reflected in the actual IIA negotiations.<sup>318</sup>

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<sup>315</sup> To know more about Indian Civil Services visit <http://www.upsc.gov.in/>

<sup>316</sup> The researcher has come to this conclusion by tracing the changes in the officials as per the details provided on the website of the Ministry of Finance and also through his visits to the Ministry of Finance.

<sup>317</sup> All the six officials of Ministry of Finance, who were interviewed, admitted to this. Even amongst the civil servants, those belonging to the Indian Administrative Service (IAS – the topmost civil service of India not based on any specific discipline or subject or domain but consisting of generalists) have better promotion opportunities over other civil servants. Thus, a civil servant belonging to the IAS has a much better chance to hold key positions even if a civil servant from another service such as the Indian Economic Service (IES – a service that selects people with minimum qualification being a post-graduate degree in Economics) is better qualified and have more technical and domain expertise. The Approach paper of the Second Administrative Reforms Commission (ARC) set up by the Government of India while emphasising on civil services reforms recognised that intricate issues in modern administration require domain expertise, long experience in a specific sector and deep insights. The present system in India does not encourage the development of such domain expertise to the fullest. Also, there is negligible encouragement for lateral entry of experts with specific and strong domain knowledge working outside the government system to join the government at key policy-making levels. Hence, the second ARC has recommended changing this practice - see Kishore (2011); Government of India (2005). Also see Government of India (2008); Government of India (2010); Government of India (2008), 190-96, 204-06.

Ministry of Finance also consults other ministries of the Government of India such as the Ministry of Commerce in the process of IIA negotiations. However, inter-ministry consultations in India are not very smooth with each ministry endeavouring to hold on to its forte and not willing to cede ground, though these consultations have certainly improved over those in the 1990s.<sup>319</sup> For example, the Ministry of Commerce while negotiating CECAs often does not involve the officials of Ministry of Finance dealing with IIAs to the desired extent. The domestic FDI policy is also made by the Ministry of Commerce whereas it is the Finance Ministry that deals with IIA negotiations. The domestic FDI regulations issued by the Commerce Ministry do not mention anything about the IIA obligations.

The inadequacy of coordination between the commerce and finance ministries on IIAs was evident during the organisation of the fourth annual forum of developing country investment negotiators in collaboration with the International Institute of Sustainable Development (IISD) and Government of India.<sup>320</sup> The aim of the forum was to develop the skills, knowledge and negotiating capacity of officials of developing countries who are involved in dealing with IIAs. The Ministry of Commerce represented the Government of India in the forum with no representation or participation of the Ministry of Finance despite it being the nodal body in India that deals with IIAs. Ministry of Finance did not participate because they were not invited.<sup>321</sup> The lack of in-depth consultation between the commerce and finance ministries has resulted in India's IIA programme standing on two legs – standalone IIAs and investment chapters in CECAs – with both having very different provisions, as mentioned above and discussed throughout the thesis.

Another player in the IIA negotiating business is the Legal and Treaties (L&T) division of the Ministry of External affairs. This division is also consulted by the Finance Ministry in IIA negotiations. The L&T division consists of officials with post graduate degrees in law and thus has some capacity to understand the complex issues related to international investment law and policy. However, this division is understaffed. Further, this division is used to feed in all international negotiations on all international law issues in which India is involved and hence very often the officials working in this division, though having the knowledge of

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<sup>318</sup> In this regard, see the arguments of Professor Qureshi who has highlighted, in context of the WTO treaty, that one group of negotiations may lack information and negotiating expertise, which should be taken into account while interpreting the treaty (circumstances of the conclusion) – See Qureshi (2006), 5.

<sup>319</sup> Interview with Ministry of Finance officials who have participated in such consultative meetings.

<sup>320</sup> Fourth Annual Forum, IISD [http://www.iisd.org/investment/dci/dci\\_forum\\_2010.asp](http://www.iisd.org/investment/dci/dci_forum_2010.asp).

<sup>321</sup> One of the officials of Ministry of Finance who was interviewed said this to the researcher.

international law, are not able to develop specialised competence and expertise in specific fields like international investment law.<sup>322</sup>

Most importantly, the final decision is made by the Ministry of Finance. It may not accept the submissions made by the L&T division of the Ministry of External Affairs.<sup>323</sup> In any case, the consultations happen only during IIA negotiations. Furthermore, the Finance Ministry also does not organise widespread stakeholder consultations while framing its policy on IIAs or while negotiating IIAs. For example, negligible or inadequate stakeholder consultations have been held on issues like whether there is a need to review India's existing IIAs due to the increasing pros and cons of ITA or more generally on issues such as whether India has gained from its IIA programme. As discussed above, no comprehensive studies are conducted before launching IIA negotiation with a particular country regarding how the proposed IIA will benefit India. It is assumed that IIAs will increase investment flows to India although there is no evidence to show that the increase in FDI inflows into India is due to IIAs or to what extent have IIAs contributed in attracting foreign investment. The reason for lack of evidence is lack of research on this issue.<sup>324</sup> There is only one study that very briefly looks at impact of IIAs on FDI inflows to India.<sup>325</sup> However, this study looks at FDI inflows into 15 Asian countries including India and hence is not India specific. Furthermore, this study is limited in offering guidance on the actual impact of IIAs on FDI inflows to India because it looks at impact of IIAs on FDI inflows between the period from 1980-81 to 1999-2000 – when India had signed only 13 IIAs as against the 73 IIAs that are in force now.<sup>326</sup> In the absence of any such evidence, the assumption of the Indian government that IIAs result in increased foreign investment is challengeable.

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<sup>322</sup> Another important point to note is that the officials of the L&T division do not belong to the All India Civil Services cadre and hence are often dominated by civil servants belonging to the all India services like the IAS and the Indian Foreign Service (IFS- India's diplomatic service, which occupies predominant place in the Ministry of External Affairs above the officials of the L&T division). The scope of promotion in the L&T division is also limited in comparison to civil servants belonging to the IAS, IFS and other civil services. These factors act as detriment for bright international law lawyers to join the government, which in turn, adversely affects India's overall ability to deal effectively with international affairs and international law issues including international investment law. Also see Gottwald (2007), 237.

<sup>323</sup> The officials of the Ministry of External Affairs made this point during the course of their interviews with the researcher.

<sup>324</sup> Ranjan (2010), 68.

<sup>325</sup> Banga (2003).

<sup>326</sup> Ranjan (2010).

Furthermore, the issue is not just limited to the central government but also extends to different state governments (or sub-national governments) in view of India's federal polity.<sup>327</sup> Thus, it is not just the actions of the central government but also the actions of state governments that can breach an IIA provision.<sup>328</sup> Notwithstanding this, there is negligible capacity in state governments of India to understand IIA provisions and their relationship with exercise of regulatory power.

## ***SUMMARY***

This chapter has shown that India's approach to foreign investment has evolved since its independence in 1947. Foreign investment figures prominently in India's economic growth strategy. This changed approach to foreign investment led India to initiate its IIA programme and enter into IIAs with more than 80 countries. However, India has been entering into IIAs without fully understanding the implications of these treaties and on the assumption that these treaties will result in increased foreign investment.<sup>329</sup> Many Indian investment treaty negotiators were surprised when told about the kind of interpretations that have been advanced by ITA tribunals and privately confirm that they didn't understand that IIAs can have such far reaching and wide effect. For example, none of the treaty negotiators had imagined at the time the India-Australia IIA was concluded that the MFN clause would be interpreted with such latitude to oblige India to pay for the 'inordinate delay' of Indian courts.<sup>330</sup> The discussion in the chapter demonstrates that there is lack of capacity in India to comprehensively understand the character of IIAs and their relationship with India's regulatory power.

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<sup>327</sup> On interaction between FDI and foreign corporations with Indian federalism see – Singh and Srinivasan (2006), 301. Also see Jha and Nair (2007).

<sup>328</sup> For example, as mentioned above, actions of the state government of Maharashtra led to the dispute between Dabhol Power Company and India under the India-Mauritius IIA.

<sup>329</sup> Also see Paulsson (1995), 257 who has argued that many countries entered into IIAs without understanding their full implications; Ewing-Chow and Teck (2008), 28. The assumption that developing countries 'knew and accepted' the costs of IIAs Also see L Poulsen (2011), *Sacrificing Sovereignty by Chance: Investment Treaties, Developing Countries and Bounded Rationality* (PhD Thesis: London School of Economics) who, in his doctoral thesis submitted to LSE, documents an incredible story of how Pakistan's Attorney General learnt about ICSID and BIT by searching the terms on the internet once Pakistan was notified by ICSID of a new investor-state arbitration

<sup>330</sup> Interview with an official of the Ministry of External Affairs.

In this regard, the assumption made by some that developing countries ‘*knew and accepted*’ costs of IIAs<sup>331</sup> does not hold good for India. Many government departments in India, both at the centre and at states, performing regulatory functions, have poor and many a times no knowledge about IIAs. The researcher interviewed officials from the Environment ministry and health ministry and found that none of them had much knowledge about IIAs and their implications.<sup>332</sup> Even within the finance and commerce ministries that are involved in negotiating IIAs, the understanding of the full ramifications of IIAs is poor. This goes on to show that whether IIAs affect India’s regulatory power cannot be understood by finding out whether India has been dissuaded from exercising regulatory power due to the known effects of IIAs on regulation. This can be inquired into by finding out, if foreign investors were to challenge India’s regulatory power, can Indian IIAs be interpreted in a manner that balance India’s regulatory power with investment protection. The four substantive chapters answer this question.

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<sup>331</sup> Montt (2009), 128. Also see Poulsen (2011), 216-256 who has challenged this assumption by interviewing officials from many developing countries to show that many developing countries didn’t fully understand the implications of IIAs.

<sup>332</sup> The theme and background information about these interviews is included in Chapter 1 under ‘Methodology’.

## CHAPTER 3

### EXPROPRIATION IN INDIAN IIAS

One of the substantive investment protection provisions that all IIAs contain is the host state's obligation not to expropriate foreign investment — 'taking' of privately owned property by the government, unless certain conditions like paying due compensation are met.<sup>333</sup> This substantive provision has attracted considerable attention in ITA.<sup>334</sup> Expropriation, in its classical sense, refers to direct or formal expropriation, which means that the host state takes away the legal title of the investment.<sup>335</sup> This can be achieved either by nationalisation, which is referred to as expropriation of entire industry or sector,<sup>336</sup> confiscation, requisition or acquisition.<sup>337</sup>

Direct expropriations, which are easily identifiable, have become rare.<sup>338</sup> As modern states adopt number of regulations to regulate various spheres of life, instances of indirect interference with investor's property rights have become more prominent. However, the difficulty is in determining when such indirect interference constitutes expropriation.<sup>339</sup> Indirect expropriation refers to the deprivation of the substantial benefits flowing from the investment without any formal 'taking' of the property.<sup>340</sup> The Iran-US Claims Tribunal in

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<sup>333</sup> Dugan *et al* (2008), 429.

<sup>334</sup> Christie (1962); Weston, (1975), 103; Newcombe (2005), t 4, ; Paulsson, (2005) Kriebaum (2007), 717; McLachlan et al (2007), 290–313 Dolzer and Schreuer (2008), 92–118; Ratner (2008), 475 Hoffmann (2008), 151; Newcombe and Paradell (2009), 341–69.

<sup>335</sup> See Salacuse (2010), 294; Sornarajah (2010), 363; Newcombe and Paradell (2009), 323; UNCTAD (2007), 56.

<sup>336</sup> Newcombe and Paradell (2009), 323; Domke (1961), 588. In this regard it is important to note that Sornarajah has distinguished between nationalisation and expropriation. According to Sornarajah 'nationalisation' implies '*across the board takings that are designed to end or diminish foreign investment in the whole economy or in sectors of the economy*' whereas expropriation is the targeting of specific business – see Sornarajah (2010), 364–67.

<sup>337</sup> For more on this see Newcombe and Paradell (2009), 323.

<sup>338</sup> *Feldman v Mexico*, ICSID Case No ARB (AF)/99/1, 16 December 2002, para 100.

<sup>339</sup> The *Feldman* tribunal recognised the difficulty by saying that direct expropriation was relatively easy whereas '*it is much less clear when the governmental action that interferes with broadly-defined property rights ... crosses the line from valid regulation to compensable taking*' para 100. See Brownlie (2008), 532; OECD (2004), 'Indirect Expropriation and Right to Regulate in International Investment Law', Working Papers on International Investment Number 2004/4; Choudhary (2008), 792–97; Van Harten (2007), 90–93; Been and Beauvais (2003), 30; Ganguly (1999), 113; OECD (2005), 43–71, Spears (2010), 1049–1052; Walde and Kolo (2001), 811; Newcombe (2005), 1; Kriebaum (2007), 717. Also see Christie (1962), 338 where the argument is that whether such regulatory interferences constitute expropriation or not need to be determined on a case to case basis.

<sup>340</sup> Dolzer and Schreuer (2008), 92; Salacuse (2010), 297; Sohn and Baxter (1961), 553. Also see Christie (1962), 309; Herz (1941), 248; Appleton (2002), 40–41.

*Starrett Housing Corporation v Iran* and *Tippetts* said the following for indirect expropriation:

... '[it] is recognized in international law that measures taken by a state can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner'.<sup>341</sup>

Whether the host country's regulatory measures result in indirect expropriation is a question that has acquired prominence due to a range of sovereign regulatory functions of host states being challenged as acts of expropriation by different foreign investors under IIAs in the last decade or so. This includes expropriation cases against Argentina for adopting regulatory measures to save itself from an extremely severe economic and financial crisis,<sup>342</sup> claims of expropriation for environment related regulatory measures,<sup>343</sup> regulatory measures aimed at addressing supply of drinking water,<sup>344</sup> regulatory measures involving sovereign functions like taxation,<sup>345</sup> regulatory measures related to telecom policy,<sup>346</sup> and other cases. There have also been cases where arbitral rulings have concluded that host state's regulatory measures amount to expropriation without providing cogent reasons for the same<sup>347</sup> or have provided broad statements that put expropriation over regulation.<sup>348</sup>

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<sup>341</sup> *Starrett Housing Corporation v Islamic Republic of Iran* (1983) 4 Iran-US CTR 122 at 154. Also see *Tippetts, Abbott, McCarthy, Stratton and TAMS-AFFA Consulting Engineers of Iran v Islamic Republic of Iran* (1984) 6 Iran-US CTR 219 at 225.

<sup>342</sup> *CMS Gas Transmission Co v Argentina*, ICSID Case No ARB/01/8; *CMS Gas Transmission Company v Argentina*, ICSID Case No ARB/01/8 (Annulment Proceedings); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3; *Enron Creditors Recovery Corp v Argentina* ICSID Case No ARB/01/3 (Annulment Proceeding); *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16; *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16 (Annulment Proceedings); *LG&E Energy Corporation v Argentina*, ICSID Case No ARB/02/1; *Continental Casualty Company v Argentina*, ICSID Case No ARB/03/9.

<sup>343</sup> See *Metalclad Corporation v United Mexican States*, Case No. ARB(AF)/97/1, 30 August 2000; *Methanex Corporation v United States*, Chapter 11 NAFTA Arbitration, 9 August 2005.

<sup>344</sup> *Biwater Gauff v Tanzania*, ICSID Case No ARB/05/22, 24 July 2008

<sup>345</sup> *Occidental v Ecuador* LCIA, 2004; *Encana Corporation v Ecuador* 45 ILM 655 (2006).

<sup>346</sup> *Telenor Mobile v Hungary*, ICSID Case No ARB/04/15

<sup>347</sup> For example, *Dugan et al* argue that in *Antoine Goetz v Burundi*, ICSID Case No. ARB/95/3 - Award - 10 February 1999, the tribunal came to the conclusion that the regulatory measure adopted by Burundi (revocation of a 'free enterprise' licence) was a measure having effect similar to expropriation in 'somewhat summary fashion' – see *Dugan et al* (2008), 449.

<sup>348</sup> For example, see *Metalclad v Mexico*, which gave an expansive definition of expropriation stating that a governmental measure depriving an investor of a significant part of anticipated profits or significantly affecting his business plans will be expropriatory (para 103). Also, see *Santa Elena v Costa Rica*, ICSID Case No ARB/96/1.



Another important factor that has also played its role in intensifying the debate on expropriation in international investment law and the host state's regulatory power is the assertion that expropriation provisions in IIAs provide better protection to foreign investments in comparison to domestic investments, which, in turn, implies that host state has lesser regulatory space available when it comes to dealing with foreign investments in comparison to domestic investments.<sup>349</sup>

In light of this overall debate on regulation and expropriation, this chapter will study the expropriation provision in 73 Indian IIAs in order to answer the central question of the thesis — will the present formulation of the expropriation provisions in Indian IIAs lead to interpretations giving precedence to investment protection over India's regulatory power? It will suggest plausible interpretations of the expropriation provisions in these 73 Indian IIAs, carefully noting the textual difference in the expropriation provision in different Indian IIAs. It will understand their implications for India's regulatory power. Also, as it will be shown, the majority of Indian IIAs do not provide for how indirect expropriation is to be determined. Thus, in the event of an expropriation dispute arising between the foreign investor and India, the arbitral tribunal will have the discretion to find out whether India's regulatory measure is, in fact, expropriation.<sup>350</sup>

Section 3.1 of the chapter studies the anatomy of the expropriation provision in 73 different Indian IIAs. The opening paragraph in all these IIAs prohibits expropriation unless or until certain conditions are met. These conditions are given in the second paragraph and the fulfillment or non fulfillment of these conditions will decide whether the expropriation is lawful or unlawful. Thus, the structure of the expropriation provision in all these 73 IIAs requires a three-step analysis to determine whether lawful expropriation has taken place.<sup>351</sup>

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<sup>349</sup> For example, see such debates in context of the US - Been and Beauvais (2003), 26; Stumberg (2009), Porterfield (2004), 15-18. For a different view see Parvanov and Kantor (2011),

<sup>350</sup> For example, in *BG Group Plc v The Republic of Argentina*, Final Award, 24 December 2007, UNCITRAL Arbitration Rules, the tribunal held that since UK-Argentina IIA does not define expropriation the tribunal will have to define it – para 258.

<sup>351</sup> This step based analysis to determine expropriation has been adopted in NAFTA – see *Fireman's Fund Insurance v Mexico* para 174; *Corn Products v Mexico*, Decision on Responsibility, 18 January 2008, paras 89 and 90. Also see *Parkerings Compagniet AS v Lithuania*, ICSID Arbitration Case No. ARB/05/8 (11 September 2007) which mentioned the two tier test – first determine whether an indirect expropriation has occurred; if the answer is positive, it will next determine whether this indirect expropriation is legitimate – para 442. In this regard see Paulsson and Douglas (2004), 145-158 who advocate a two step analysis to determine expropriation – 1) the nature and extent of interference with the investor's property rights in such a manner as to constitute taking; 2) determining whether this taking amounts to expropriation. One author has given a three stage analysis – 1) find out whether there is total or substantial deprivation; 2) exceptions – where the state, notwithstanding

First, determining whether the investor has an investment that has been interfered with by India in exercise of its sovereign power;<sup>352</sup> second, determining whether this interference with investment amounts to expropriation; third, if indeed this interference amounts to expropriation, then determining whether this expropriation is pursuant to public policy, has been carried out in accordance with law, is non-discriminatory and whether due compensation has been paid to the foreign investor.<sup>353</sup>

For this thesis, the second step is the crux of the matter because it helps in finding out whether a regulatory measure is regulation or expropriation.<sup>354</sup> Hence, section 3.2 of the chapter will focus on this step. This section will discuss whether the existing formulation of the expropriation provisions in 73 Indian IIAs support an interpretation that balances investment protection with India's regulatory power. This section will also juxtapose expropriation provision in these 73 Indian IIAs with how expropriation is understood in Indian law to demonstrate that India's international obligations on expropriation is broader than India's understanding on it in domestic law. Section 3.3 discusses the issue of compensation for expropriation.

### ***3.1 ANATOMY OF EXPROPRIATION PROVISION IN INDIAN IIAs***

All the 73 IIAs cover both direct and indirect expropriation. The formulation of the expropriation provision in these 73 Indian IIAs can be divided into two types. First, the 'limited-content' type expropriation formulation, which gives limited indication on determining indirect expropriation. In these IIAs the focus is only on effect of the regulatory measure to determine indirect expropriation. Since these IIAs provide only one indicator to determine indirect expropriation, they are referred as 'limited-content'. Expropriation provision in 57 IIAs belongs to this category. Second, the 'content-indicative' type expropriation provision, which contains certain factors that need to be taken into account to determine indirect expropriation. These IIAs focus on effect but also provide many other factors that should be used in determining indirect expropriation and hence are referred as

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the total deprivation, is able to successfully defend based on domestic law or pre-eminent public interests; 3) counter exceptions – claims by investors that step-two exceptions were improperly and arbitrarily applied – Montt (2009), 236.

<sup>352</sup> Also see *Chemtura v Canada*, NAFTA Award, UNCITRAL, 2 August 2010, para 257.

<sup>353</sup> For a general discussion on lawful expropriation see – Reinisch (2008), 171.

<sup>354</sup> Schreuer (2006), 111.

‘content-indicative’. The expropriation provision in 16 IIAs belongs to this group (Table 3.1). Both these types are discussed below.

**Table 3.1 – Anatomy of Expropriation provision in Indian IIAs**

Expropriation formulation type	Number of IIAs
‘Limited-Content’	57
‘Content-Indicative’	16

*Source – Author’s study of 73 Indian IIAs*

### 3.1.1 ‘Limited-Content’ Type

Out of the 57 ‘limited-content’ expropriation provision, the expropriation provision in as many as 46 IIAs provides ‘*investments shall not be nationalised, expropriated or subject to measures having effect equivalent to nationalisation or expropriation*’ ... Thus, as per these 46 IIAs, India is not only prohibited from nationalising and expropriating foreign investment but also from adopting a regulatory measure that has effect equivalent to nationalisation or expropriation. These IIAs are with developed countries like Netherlands, Denmark, Germany, UK and with developing countries like Sri Lanka, Vietnam, Oman, Indonesia and Myanmar. Further, this includes IIAs signed in the mid-1990s and also those signed in late 2000, though majority of these IIAs were signed during the mid-1990s and first half of 2000, barring IIAs with countries like – Macedonia (signed and enforced in 2008), Libya (signed in 2007 and enforced in 2009) and Myanmar (signed in 2008 and enforced in 2009). In other words, there is no distinct pattern amongst the expropriation provision in Indian IIAs containing such formulation.

More or less same formulation exists in two more IIAs; India-Morocco IIA – ‘*any other measure having equivalent effect*’; and India-France IIA – ‘*any other measure having the effect of dispossession*’.

In this ‘limited-content’, there are five IIAs (India-Kuwait; India-Qatar; India-Uzbekistan; India-Mexico and India-Turkey) that contain the word ‘effect’ along with the word ‘indirect’.

For example, India-Qatar IIA states '*the investment shall not be subject, either directly or indirectly, to any act of expropriation or nationalisation or to any other procedure of similar effect ...*'. Thus as per this provision, India cannot expropriate foreign investment either directly or indirectly nor can it subject foreign investment '*to any other procedure of similar effect*'.<sup>355</sup> The India-Mexico IIA states that neither country may expropriate or nationalise an investment '*either directly or indirectly through measures tantamount to expropriation or nationalisation*'. Thus, the expropriation provision in India-Mexico IIA does not talk about 'effect' equivalent to expropriation. Similarly, India-Austria IIA does not talk of 'effect' equivalent to expropriation. It only states that '*investments shall not be expropriated*'.

### 3.1.2 'Content-indicative' Type

The expropriation provisions in 16 Indian IIAs,<sup>356</sup> like the other 57 IIAs, state that investments shall not be nationalised, expropriated, or subjected to '*measures having effect equivalent to nationalisation or expropriation*'. However, there is an important difference. These 16 IIAs, unlike the 'limited-content' IIAs, provide specific factors that should be taken into account in determining 'measures having effect equivalent to expropriation'. These criteria include not just the 'economic impact' of the regulatory measure on foreign investment but also other factors like the extent to which the measures are discriminatory either in scope or in application; the extent to which measures interfere with distinct, reasonable, investment-backed expectations; and the character and intent of the measures (Table 3.2).

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<sup>355</sup> Article 1110 (1) of NAFTA provides – '*no Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation*'. In *Waste Management v Mexico* ICSID Case No. ARB(AF)/00/3 the tribunal held that the phrase '*take a measure tantamount to nationalization or expropriation*' was intended to add to the meaning of the prohibition over and above the reference to indirect expropriation (paras 143 and 144). This argument that there exists a third category of expropriation in addition to 'direct' and 'indirect' has been rejected by other arbitral tribunals - see *Pope and Talbot*, where the tribunal held that in Article 1110 (1) of NAFTA, 'a measure tantamount to nationalization or expropriation' means nothing more than a 'measure equivalent to nationalization or expropriation' – see paras 96 to 104. The same was said by the *Telenor* tribunal that measures such as 'equivalent to expropriation' or 'measures having similar effect' do not expand the concept of expropriation but means that the IIA includes both indirect and direct expropriation – para 63. Thus, the phrase '*any other procedure of similar effect*' is same as 'indirect' expropriation and does not expand the ambit of expropriation into a third category beyond the well established categories of 'direct' and 'indirect' expropriation - see Salacuse (2010), 300; Vandevelde (2009), 479.

<sup>356</sup> These 16 IIAs are with the following countries - Slovak Republic; Trinidad and Tobago; China; Iceland; Saudi Arabia; Brunei Darussalam; Syria; Jordan; Mozambique; Senegal; Lithuania; Latvia, Singapore, Korea, Japan and Malaysia

**Table 3.2 – Determining Indirect Expropriation in Indian IIAs**

<b>Expropriation provision Type</b>	<b>Determining Indirect Expropriation</b>
‘Limited-Content’	‘measures having effect equivalent to expropriation’
‘Content-Indicative’	‘measures having effect equivalent’ to expropriation’; but also provides factors like ‘economic impact’ and ‘character of the measure’ that should be taken into account to determine such measures.

*Source – Author’s study of 73 Indian IIAs*

### **3.2 DETERMINING INDIRECT EXPROPRIATION**

The majority of Indian IIAs (in both categories) state *‘investments shall not be nationalised, expropriated or subject to measures having effect equivalent to nationalisation or expropriation’*... This formulation is same as it appears in many other IIAs that have been interpreted by different arbitral tribunals. Hence, the section will first briefly discuss the different approaches that arbitral tribunals have adopted to determine indirect expropriation. The section will then focus on how to determine indirect expropriation in ‘limited-content’ and ‘content-indicative’ Indian IIAs based on the treaty language.

#### **3.2.1 Effect vis-à-vis Purpose?**

Many arbitral tribunals have followed the ‘sole effects’ doctrine to determine indirect expropriation. As per this doctrine, the focus should solely be on ‘effect’ of the regulatory measure on foreign investment to determine indirect expropriation. The justification for relying on this doctrine is textual — the expropriation provision in the IIA contains only the

word ‘effect’. For example, in *Siemens v Argentina*,<sup>357</sup> Argentina argued that tribunal should not take into account only the ‘effect’ of the measure on foreign investment.<sup>358</sup> However, the tribunal dismissed Argentina’s argument and held – first, Article 4(2) of the Germany-Argentina IIA refers to ‘effect’ of the measure and not to the intent of the state to expropriate.<sup>359</sup> Second, ‘purpose’ of the expropriation is one of the requirements to determine whether expropriation is in accordance with the IIA and not to determine whether an expropriation has occurred or not<sup>360</sup> (the second point is discussed later in the chapter while discussing the argument on ‘purpose’ to determine expropriation). Similarly, in *AWG v Argentina*,<sup>361</sup> where the expropriation provision in the UK-Argentina IIA contains the phrase ‘*subjected to measures having effect equivalent to nationalisation or expropriation*’, the tribunal held that specific reference to ‘effects’ in the IIA ‘*affirms the importance of evaluating ‘effects’ of the measure on the investment in determining whether an expropriation has taken place*’.<sup>362</sup> In *Encana v Ecuador*, the Canada-Ecuador IIA, which was under consideration, had almost similar formulation of the expropriation provision as found in majority of Indian IIAs – ‘*subjected to measures having an effect equivalent to expropriation*’. In this case, the tribunal focused on the ‘effect’ of the measure on foreign investment to determine whether indirect expropriation had occurred or not.<sup>363</sup>

Focus on ‘effect’ of the regulatory measure to determine indirect expropriation raises the question of how severe the ‘effect’ should be to come to the conclusion that indirect expropriation has taken place?

Tribunals have answered this question by saying that ‘*under international law, expropriation requires a ‘substantial deprivation*’.<sup>364</sup> In other words, tribunals have said that the effect should be such that substantially deprives the investment and hence the test is of ‘substantial

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<sup>357</sup> *Siemens v Argentina*, ICSID Case No. ARB/02/8, 6 February 2007.

<sup>358</sup> *Siemens tribunal*, para 270.

<sup>359</sup> *Id.*

<sup>360</sup> *Id.*

<sup>361</sup> *AWG v Argentina*, ICSID Case No. ARB/03/19, 30 July 2010.

<sup>362</sup> *Id.*, para 133.

<sup>363</sup> *Encana v Ecuador*, paras 173-78. Also see *Tippets, Abbott, McCarthy Stratton v TAMS AFFA Consulting Engineers of Iran*, (1984), 6 Iran-US CTR 219 at 225-26; *Starrett Housing Corp v Iran*, 4 Iran-US CTR 122, *Enron v Argentina*, para 244 and *Patrick Mitchell v The Democratic Republic of Congo* (Annulment Proceedings) ICSID Case No ARB/99/7, para 53 for ‘sole effect’ doctrine. Also see *Vivendi II; Bayindir v Pakistan*, para 459 stating that one needs to focus on ‘effect’ of the measure and not the intent underlying the purpose; *Impregilo SpA v Argentina*, ICSID Case No. ARB/07/17, para 270 also talks of ‘effect’ of the measure on investment to determine expropriation.

<sup>364</sup> *Pope and Talbot Inc v Canada*, Ad hoc tribunal (UNCITRAL arbitration rules), para 96.

deprivation’ to determine indirect expropriation.<sup>365</sup> Recently, the arbitral tribunal in *AWG v Argentina* also endorsed the ‘substantial deprivation’ test in determining indirect expropriation.<sup>366</sup> The effect can certainly be more than substantial such as cases where the deprivation is complete or total. For example, the tribunal in *Total SA v Argentina*<sup>367</sup> held that under international law those measures that do not constitute direct expropriation may nevertheless result in indirect expropriation ‘if an effective deprivation of the investment is thereby caused’.<sup>368</sup> The tribunal further said that effective deprivation requires a total loss of value of the property.<sup>369</sup> The *Total* tribunal provide for a higher threshold by emphasising on total deprivation in comparison to those tribunals that require substantial deprivation.

The determination of whether there is substantial deprivation will depend on different factors such as the factors given by the *Pope and Talbot* tribunal like control over investment; whether the investor is able to manage the day to day operations of the investment; whether officers or employees of investment have been detained by the state; whether the state supervises the work of the employees of the investment; whether any part of the sale proceeds (apart from taxation) go to the state; whether the state prevents payments of dividends to share holders; whether the state interferes with appointment of directors.<sup>370</sup> Many investment arbitration tribunals that have focused on the ‘substantial deprivation’ test, referring to the indicators given in *Pope and Talbot*, have looked at control over investment as a key indicator to determine indirect expropriation. For example, in *Enron v Argentina*, the tribunal said that the list of measures given by the *Pope and Talbot* tribunal are representative of the legal standard required to determine indirect expropriation and emphasised on control over investment as an integral part of ‘substantial deprivation’.<sup>371</sup> This has been described as

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<sup>365</sup> *PSEG v Turkey*, ICSID Case No. ARB/02/5, paras 278-80; *CMS v Argentina*, para 262. Also see other Argentina cases that have endorsed the ‘substantial deprivation’ test to determine indirect expropriation – *LG&E v Argentina*, para 194; *Sempra v Argentina*, paras 284-85; *BG Group v Argentina*, paras 258-66; *Enron Corporation v Argentina*, para 245. Also see *Tecmed v United Mexican States*, ICSID Case No ARB(AF)/00/2 para 115; *CME v Czech Republic*, (Final Award) 14 march 2003, para 604. This test was also repeated in *Corn Products International v Mexico*, ICSID Case No ARB/AF (04) (01), 15 January 2008, para 91 stating that in cases where there is no physical taking of the property or forcible transfer of title, ‘taking’ must be a substantially complete deprivation of the economic use and enjoyment of rights to property. Also see Higgins (1982), 324.

<sup>366</sup> *Id.*, para 134. Also see *Chemtura Corporation v Canada* Ad Hoc NAFTA Arbitration under UNCITRAL Rules (2 August 2010), para 242; *Tokoils Tokeles v Ukraine*, ICSID Case No ARB/02/18, para 120. Also see Schreuer (2006), 145; Hoffman (2008), 156-59.

<sup>367</sup> *Total SA v Argentina*, ICSID Case No. ARB/04/01, 27 December 2010.

<sup>368</sup> *Id.*, para 195.

<sup>369</sup> *Id.* Also see *El Paso v Argentina*, ICSID Case No. ARB/03/15, 31 October 2011, para 244.

<sup>370</sup> *Pope and Talbot*, para 100. Also see Walde and Kolo (2001), 811 at 837-38.

<sup>371</sup> *Enron v Argentina*, para 245. Similarly, in *CMS v Argentina* the tribunal held “control over investment” as integral to determining ‘substantial deprivation’ – para 263. Also see *PSEG v Turkey* para 278. The Feldman

the legal approach.<sup>372</sup> In distinction to the legal approach, some arbitral tribunals have focused on the economic approach emphasising on the substantial deprivation of the value of the investment.<sup>373</sup> In distinction to this, recently, in *Chemtura v Canada*, the tribunal preferred an approach that takes into account both the legal and economic effect of the regulatory measure on the investment to determine whether there has been a substantial deprivation. The tribunal, discussing the list of measures laid down by *Pope and Talbot* tribunal, held that the criteria must guide the tribunal in determining whether the ‘effects’ of the measures challenged are to ‘substantially’ deprive the investor of the benefit of its investment – this being a matter of degree and not one of specific conditions.<sup>374</sup> The *Chemtura* tribunal also said that determination of substantial deprivation is a fact-sensitive exercise, which should be carried out in view of the circumstances of each case.<sup>375</sup>

### *Purpose Test*

Contrary to the ‘sole effects’ test to determine indirect expropriation, supported by majority of arbitral tribunals, is another test supported by some arbitral tribunals<sup>376</sup> and scholars<sup>377</sup> that talks of looking at the purpose of the measure along with the effect of the measure. This is referred as the ‘purpose’ test. The ‘purpose test’ attempts to remedy the concern that application of the ‘sole effects’ test will fail to distinguish between *malafide* and *bonafide* regulatory measures if both have the same effect of substantially depriving the investment.<sup>378</sup> The ‘purpose-test’ promises to address this concern and hence serve host country’s regulatory

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tribunal said that while effective control over investment was important, it was not necessarily determinative – see Meg N Kinnear, A Bjorklund, John FG Hannaford, *Expropriation and Compensation*, 1110-24.

<sup>372</sup> Montt (2009), 262.

<sup>373</sup> *Telenor v Hungary* which required ‘a major adverse impact on economic value of the investment’ – para 64 and *Parkerings-Compagniet v Lithuania*, requiring substantial decrease in the value of the investment as one of the requirements to determine indirect expropriation – para 455. Also see *Total SA v Argentina*, para 195.

<sup>374</sup> *Chemtura v Canada*, para 247. Also see *Tokios Tokelés v Ukraine*, where the tribunal held that for any expropriation – direct or indirect – the state must deprive the investor of a ‘substantial’ part of the value of the value of investment and determination will depend on the facts before the tribunal – para 120; Reinisch (2008), 438-39. Also see Dolzer and Schreuer (2008), 107-08.

<sup>375</sup> *Chemtura v Canada*, para 249.

<sup>376</sup> *Methanex v USA*; *Tecmed v Mexico*; *LG&E v Argentina*; *El Paso v Argentina*.

<sup>377</sup> See Salacuse (2010), 317-18;

<sup>378</sup> Fortier and Drymer (2004), 293; Paparinskis (2011), 299. Also see Salacuse (2010), 317. In this regard, it has been argued that the effects-only approach should be applied in cases of disguised expropriation and those substantial interferences with property rights that are in breach of due process – Paparinskis (2011), 304. the *Azurix* tribunal had observed that arbitral tribunals are divided on the issue that whether only effect of the measures on investment should be considered or both the effect and the purpose behind the measure should be considered – *Azurix* tribunal, para 309. Also see Lowe (2007), 75-76 – pointing out the real uncertainty over criteria to distinguish between lawful regulation and unlawful expropriation.



power. The ‘purpose-test’ can also be seen as a response to the criticism that IIAs do not balance investment protection with host country’s regulatory power. However, it needs to be ascertained whether this response is compatible with the language of the treaty (IIAs) and with the treaty interpretation tools.

The ‘purpose-test’ to determine indirect expropriation can take two forms.

### Police Power test

As per the police power test, once it is determined that there is substantial deprivation, then focus shifts to determining whether the impugned regulatory measure was a non-discriminatory regulatory measure for public purpose applied following due process or not. If so, then notwithstanding the effect of the measure on foreign investment, it will not amount to expropriation.<sup>379</sup> The best exposition of this test is provided by the tribunal in *Methanex v United States*. In this case, the tribunal held that:

*...as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.*<sup>380</sup>

Similarly, the *Saluka* tribunal held that:

*...it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.*<sup>381</sup>

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<sup>379</sup> *Methanex* tribunal, Part IV, Chapter D, para 7; Paparinskis (2011), 311-19; Reinisch (2008), 437; Vandevelde (2009), 301-02; Fortier and Drymer (2004), 313-25; Subedi (2008), 163; Mostafa (2008), 273-74.

<sup>380</sup> *Methanex v United States*, Part IV, Chapter D, para 7. Also see S Fietta (2006), 391 has argued that such language that focuses more on specific commitments to foreign investors and less on interference is reminiscent more of an ‘FET’ analysis than ‘expropriation’. Also see *Encana Corp v Republic of Ecuador*, 3 February 2006 which said that denial of legitimate expectation does not amount to expropriation.

<sup>381</sup> Recently, the tribunal in *El Paso v Argentina* stated ‘in principle, general non-discriminatory regulatory measures, adopted in accordance with the rules of good faith and due process, do not entail a duty of compensation’ - *El Paso v Argentina*, para 240. The exception that the tribunal recognised to this general rule is that if regulatory measures are unreasonable, they can be considered as ‘amounting to indirect expropriation if

Thus, as per these rulings adoption of non discriminatory regulatory measures for public purpose following due process do not amount to expropriation even if they have the effect of substantially depriving foreign investment.<sup>382</sup>

### Proportionality test

As per the proportionality test, determination of indirect expropriation will depend on whether the regulatory measure is proportionate to the purpose sought to be achieved.<sup>383</sup> The proportionality test will have three steps.<sup>384</sup> First, whether the measure is suitable for the legitimate public purpose — this will require a causal link between the measure and its object.<sup>385</sup> Second, whether the measure is necessary; and the third step will involve balancing the effects of the measure on the right that has been affected with the public benefit sought to be achieved by the measure.<sup>386</sup> This test will weigh and balance purpose with effect and hence arguably appears attractive to solve the conundrum between regulation and expropriation.<sup>387</sup>

The *Tecmed* tribunal, for the first time, applied this test in ITA. The tribunal cited the European Court of Human Rights (ECHR) jurisprudence to support the proportionality test and applied it to interpret the expropriation provision given in Article 5(1) of the Mexico-Spain IIA. The tribunal also emphasised the presence of the word ‘effects’ in the expropriation provision in Article 5(1) of the Mexico-Spain IIA to support that effects of the

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*they result in a neutralisation of the foreign investor’s property rights’ - Id*, para 241. The approach of the *El Paso* tribunal is close to the *Methanex* tribunal though it recognises more exceptions to the general rule that non-discriminatory; good faith regulation does not amount to expropriation.

<sup>382</sup> For more on this test see Dolzer and Schreuer (2008), 109-111; Sornarajah (2010), 374-75; Kriebaum (2007), 724-27. It is also important to note that in none of these cases the concerned expropriation provision contained the word ‘effect’ on foreign investment as the criterion to determine indirect expropriation – in *Methanex*, the relevant phrase was ‘tantamount to expropriation’ and in *Saluka* the relevant word was ‘deprivation’. In fact, the *Saluka* tribunal said that the relevant expropriation provision in the IIA was drafted in a very broad manner - para 254. It is also important to note that *Saluka*’s position on this point is more nuanced as compared to *Methanex*. The *Saluka* tribunal after saying that states are not liable to compensate for bonafide non discriminatory regulatory measures also said that the tribunal will determine whether the measure is bonafide or not by assessing the context in which the impugned measure was adopted – *Saluka*, para 264.

<sup>383</sup> *Tecmed v Mexico*.

<sup>384</sup> Xiuli (2006), 636-37; Kinsbury and Schill (2010), 85-88. Also see Coe and Rubins (2005).

<sup>385</sup> *Id*. Also see Hans (2000), 240.

<sup>386</sup> *Id*.

<sup>387</sup> Coe and Rubins (2005), 664.

action have to be taken into account in determining the economic deprivation of the investment.<sup>388</sup> However, after emphasising that regulatory measures *per se* are not excluded from the ambit of expropriation, the tribunal introduced the notion of proportionality to decide whether the regulatory measure is proportional to the public interest it wishes to protect.<sup>389</sup> The tribunal, relying on the ECHR jurisprudence,<sup>390</sup> stated:

*...there must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.*<sup>391</sup>

And:

*...the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitled to exercise political rights reserved to the nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors.*<sup>392</sup>

The tribunal relied on the ECHR jurisprudence to support this pronouncement.<sup>393</sup> This test has been supported by some other arbitral tribunals as well.<sup>394</sup> It has also been argued that the proportionality test helps to achieve a balance between affected property right and the public interest.<sup>395</sup>

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<sup>388</sup> *Tecmed v Mexico*, para 115.

<sup>389</sup> *Id.*, para 122.

<sup>390</sup> In the case of *Mellacher and Others v Austria*, judgment of 19 December 1989, 48, p. 24; In the case of *Pressos Compañía Naviera and Others v Belgium*, judgment of 20 November 1995, 38, p. 19; In the case of *James and Others*, judgment of 21 February 1986, 50, pp.19-20, <http://hudoc.echr.coe.int>.

<sup>391</sup> *Tecmed v Meico*, para 122.

<sup>392</sup> *Id.*

<sup>393</sup> In the case of *James and others*, judgment of 21 February 1986.

<sup>394</sup> *LG&E v Argentina*, para 195; *Azurix v Argentina*, ICSID Case No. ARB/01/12, 14 July 2006, para 312; *El Paso v Argentina*, para 241. The *Azurix* tribunal did not apply the proportionality test – it found no expropriation on the basis of impact of the measure being insufficient on investment. The arbitral tribunal in *Fireman's Fund v Mexico* said (in footnote 162) after noting that the principle of proportionality was used by the *Tecmed* tribunal said ‘*The factor is used by the European Court of Human Rights ... and it may be questioned whether it is a viable source of interpreting Article 1110 of the NAFTA*’. Reference to proportionality was also made in *Continental*, para 276. Also see Ratner (2008), 457. Also see Salacuse (2010), 317-18; Newcombe and Paradell (2009), 362-64; Coe and Rubins (2005). Also see Sweet (2010).

<sup>395</sup> Brower and Schill (2009), 486. Also see Fortier and Drymer (2004), 326; Muchlinski (2007); Ratner (2008), 482-83; Moloo and Jacinto (2011). In this regard, it has also been argued that the approach adopted by the *Tecmed* tribunal is not supported by much authority – see Ewing-Chow and Teck (2008), 38.

### 3.2.2 'Limited-Content' Type – Interpretation

The determination of indirect expropriation in these 57 'limited-content' expropriation provisions cannot be made by relying simply on a particular test or doctrine. This determination has to be made by keeping in the mind the treaty language — '*measures having effect equivalent to nationalisation or expropriation*' — and by interpreting this language using treaty interpretation tools like giving ordinary meaning to the words used in view of the context and in light of the object and purpose of the treaty. Other tools such as 'any other rule relevant between the parties' – given in Article 31(3)(c) are also relevant. For example, the *Saluka*<sup>396</sup> tribunal relied on Article 31(3)(c) to import customary international law into the expropriation provision of the concerned IIA to interpret expropriation.<sup>397</sup>

The formulation '*measures having effect equivalent to nationalisation or expropriation*' has two parts. One part focuses on 'effect' of the measure on foreign investment and the other part focuses on 'equivalence' of effect to nationalisation and expropriation.

#### *Focus on effect*

According to the phrase determination of indirect expropriation depends on the 'effect' of the regulatory measure on foreign investment. The expropriation provision in the 'limited-content' IIAs does not mention any other factor to take into account for the determination of indirect expropriation. The focus solely on 'effect' brings into focus the 'sole effects' doctrine<sup>398</sup> to determine indirect expropriation.

Since a majority of 'limited-content' type expropriation formulation specifically mentions only the requirement to take into account 'effects' of the measure in determining expropriation, there is a strong argument, on a clear textual basis, to look solely at 'effects' of the measure in determining whether an Indian regulatory measure amounts to indirect expropriation.<sup>399</sup> Contrary to the argument that tribunals should rely solely on 'effects' of the

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<sup>396</sup> *Saluka Investments v The Czech Republic*

<sup>397</sup> Id, para 254.

<sup>398</sup> Dolzer (2002), 79.

<sup>399</sup> With regard to giving significance to treaty language for determining expropriation see - Poulsson and Douglas (2004) 155 who have argued that the finding of the *Goetz* tribunal was due to the expropriation

measure on investment to determine indirect expropriation is the argument that one should also take into account the ‘purpose’ of the measure.<sup>400</sup> This argument is discussed later in the chapter.

### *Equivalent to Expropriation – Substantial Deprivation*

The phrase mentioned above, apart from focusing on ‘effect’, also requires that the effect on foreign investment should be equivalent to nationalisation or expropriation for it to be expropriatory. The dictionary meaning of the word ‘equivalent’ is ‘similar or identical’. Thus, if a regulatory measure adopted by India has effects that are similar or identical to the effect had the investment been nationalised or directly expropriated, then the regulatory measure will constitute indirect expropriation. Effects of direct expropriation are that the investor will be deprived of his investment; lose control over investment and fail to reap economic benefits from investment — in other words, fail to use, enjoy or dispose property or lose all fundamental rights of ownership.<sup>401</sup> The *Feldman* tribunal characterised the effect of direct expropriation as ‘*depriving the investor of all meaningful benefits and ownership and control*’.<sup>402</sup> Thus, if any regulatory measure adopted by India has effects that are similar to the investor losing the right to meaningful utilisation of investment or in simpler terms there is ‘substantial deprivation’ of the investment,<sup>403</sup> the regulatory measure will be expropriatory.<sup>404</sup>

Hence, ‘*measures having effect equivalent to nationalisation or expropriation*’ in 57 ‘limited-content’ expropriation provision provide an indirect textual basis to the ‘substantial deprivation’ test. An important offshoot of this is that not any effect on foreign investment that results in economic hardship will qualify as indirect expropriation.<sup>405</sup> This allows enough

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provision in the IIA between Belgium/Luxembourg and Burundi fused ‘taking’ and ‘expropriation’ and thus any ‘taking’ had to be compensated.

<sup>400</sup> Salacuse (2010), 317.

<sup>401</sup> Sohn and Baxter (1961), 553, 559; Brownlie (2008), 531; Weston (1976), 103-75.

<sup>402</sup> *Feldman v Mexico*, para 100. Also see *Fireman’s Fund v Mexico*, ICSID Case No. ARB(AF)/02/01, which said that effect of expropriation is dispositive (para 176).

<sup>403</sup> Mostafa (2008), 280. The effect may not be total deprivation but substantial deprivation, see - *Pope and Talbot Inc v Canada* (UNCITRAL, NAFTA), Interim Award, 26 June 2000, para 96.

<sup>404</sup> Also see Vandevelde (2009), 294. In *Impregilo v Pakistan*, concerning the expropriation provision of the Italy-Pakistan IIA containing the phrase ‘*subjected to any measures having similar effects*’, the tribunal said that ‘*the effect of the measures taken must be of such importance that those measures can be considered as having an effect equivalent to expropriation*’ – para 279. Also see Lowe (2007); Dolzer and Stevens (1995), 100.

<sup>405</sup> Hoffman (2008), 159. For example, the tribunal in *Impregilo v Argentina* held that ‘*Expropriation is to be distinguished from less far-reaching measures which regulate or restrict the right to use property. Such*

space for India to adopt regulatory measures for its various regulatory needs even if they result in adverse economic effect on foreign investment till this effect does not reach the high threshold of substantial deprivation.<sup>406</sup> This threshold will be even higher if the deprivation required is total as held in *Total SA v Argentina*.<sup>407</sup> Thus, any Indian regulation that reduces profits of foreign investment or that results in other economic hardships but do not reach the threshold of substantial deprivation will not qualify as ‘*measure having effect equivalent to expropriation*’. As the Argentina cases demonstrate that even in situations of severe economic crisis that had other social and political fall outs, Argentina’s regulatory measures did not result in substantial deprivation of foreign investments and hence no indirect expropriation was found, though Argentina was guilty of breaching other IIA provisions like FET.

This interpretation is also consistent with the customary international law principle that a country has the right to regulate its internal affairs.<sup>408</sup> Hence, this interpretation serves India’s regulatory power although one should not forget that the arbitral discretion may still be exercised in favour of adopting an expansive interpretation on the lines of the definition of expropriation given in *Metalclad*<sup>409</sup> or *Occidental*.<sup>410</sup>

### *Conceptual Severance*

The indirect textual reference to the ‘substantial deprivation’ test in ‘limited content’ expropriation does not answer one question — ‘substantial deprivation’ of which investment? Let us assume that a foreign investor runs an enterprise and this enterprise is entitled to get a tax refund. Further assume that this tax refund has been denied due to a new regulatory measure adopted by India; however, this denial of tax refund has not affected the investor’s enterprise as a whole. The question will be: is non payment of the tax refund due to the

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*measures may also have serious economic effects for the investor but do not constitute expropriation*’ - *Impregilo v Argentina*, para 270. Also see Mostafa (2008), 282-84.

<sup>406</sup> Moloo and Jacinto (2011), 24.

<sup>407</sup> *Total SA v Argentina*, ICSID Case No. ARB/04/1), 27 December 2010.

<sup>408</sup> Also see Vandeveld (2009), 271.

<sup>409</sup> Ewing-Chow and Teck (2008), 33. Also see Dearden (1995), 117-21 supporting a broad view on expropriation.

<sup>410</sup> In *Occidental Exploration v Ecuador* the tribunal stated ‘*the respondent in this case did not adopt measures that could be considered as amounting to direct or indirect expropriation. In fact, there has been no deprivation of the use or reasonably expected economic benefit of the investment, let alone measures affecting a significant part of the investment*’ (para 89). In other words, the Occidental tribunal recognised ‘deprivation of the use or reasonably expected economic benefit of the investment’ as the test to determine indirect expropriation.

foreign investor expropriation?<sup>411</sup> It is here that an arbitral tribunal will enjoy discretion in determining whether a regulatory measure adopted by India amounts to indirect expropriation.

This brings us to the issue of conceptual severance.<sup>412</sup> Conceptual severance implies breaking the bundle of rights of the foreign investor into different individual rights and then assessing whether the state's regulatory measure interfering with any of these individual rights is to the extent of taking away the right and whether this taking amounts to expropriation. In the above example, one approach that an arbitral tribunal can take is to sever 'rightful claims to money' from the overall bundle of the investor's rights and then come to the conclusion that since this is recognised as investment in all the 'limited-content' IIAs, refusal to pay tax refund is total deprivation of 'rightful claims to money' and thus expropriation. For example, in *Eureko v Poland*, the tribunal held that since Poland deprived the investor from buying additional shares in a company, and which was an asset under the IIA; this deprivation amounted to expropriation notwithstanding the fact that the investor's existing shares in the company had not been affected and in fact continued to earn dividends.<sup>413</sup> Thus, in this case, the right to buy additional shares was severed from the overall investment activity to come to the conclusion that the right to buy additional shares had been indirectly expropriated. On the other hand, another approach that can be taken is that if investor's enterprise is taken as a whole, then non-payment of tax refund shall not amount to expropriation because this has not substantially deprived the investor's overall enterprise or overall investment taken as a whole. The *Telenor* tribunal adopted this approach: '*the investment must be viewed as a whole and that the test the tribunal has to apply is whether, viewed as a whole, the investment has suffered substantial erosion of value*'.<sup>414</sup>

Since the expropriation provision in the 'limited-content' expropriation provisions does not provide any guidance on conceptual severance, this determination is open to different interpretations. Thus an arbitral tribunal can adopt the position taken in *Eureko v Poland* to sever individual rights and to look at the impact on these rights to decide an indirect

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<sup>411</sup> See *GAMI Investments v United Mexican States*, UNCITRAL, 15 November 2004, tribunal, paras 125-29.

<sup>412</sup> Radin (1993), 127-28; Newcombe and Paradell (2009), 347-49. This has also been conceptualised as the 'problem of denominator' – see Montt (2009), 265-73. Also see Dolzer and Schreuer (2008), 106-08.

<sup>413</sup> *Eureko v Poland*, paras 239-242; Montt (2009), 269; U Kriebaum (2007), 'Partial Expropriation', 8 *Journal of World Investment and Trade*, 69. Also see *Encana v Ecuador*, paras 183, 188, 189 and 193; *Waste Management II*, para 141.

<sup>414</sup> *Telenor*, para 67.

expropriation claim. Such severance, depending on its degree, may result in India's regulatory measures being held expropriatory. The Indian thinking on this issue is not known.<sup>415</sup> However, in the recent ITA case involving India, (*White Industries v India*) India argued that the correct test to determine indirect expropriation is to assess the impact of the state's behaviour on the rights of the investor in the investment and not the impact on the value of the investment.<sup>416</sup> Thus, India favoured an approach similar to the one adopted by the *Eureko* tribunal.<sup>417</sup>

### *'Limited-content' Expropriation provision and the 'Purpose' Test*

The discussion below will show that although the 'purpose-test' promises to serve India's regulatory power, the formulation of the 'limited-content' type expropriation provision and the structure of the Indian IIAs do not allow the adoption of 'purpose' test to interpret these expropriation provisions. This is discussed under the following heads – public purpose; presence of NPM provision; and the context of Indian IIAs.

### Public Purpose

Both versions of 'purpose' test take into account 'public purpose' as the criterion to determine indirect expropriation. However, the phrase '*measures having effect equivalent to nationalisation or expropriation*' contains only 'effect' as the criterion to determine indirect expropriation and not 'public purpose'. For example, Article 5(1) of the India Germany IIA states:

*Investments of investors of either contracting party shall not be expropriated, nationalised, or subjected to measures having effect equivalent to nationalisation or expropriation in the territory of the other contracting party except in public interest, authorised by the laws of that party, on a non-discriminatory basis and against compensation.*

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<sup>415</sup> India's current and former investment treaty negotiators when asked about this question had no answer to offer. It was pointed out that these issues have not been examined and thought out in detail.

<sup>416</sup> *White Industries v India*, UNCITRAL, 30 November 2011, paras 5.5.5 and 12.3.5.

<sup>417</sup> The tribunal declined to rule on this issue – *White Industries v India*, para 12.3.6.



In all Indian IIAs containing the ‘limited-content’ expropriation formulation, ‘public purpose’ exists as a criterion to determine lawful expropriation and not expropriation, which is the first of the two analytical steps to be performed in interpreting expropriation provision: first, determination of expropriation; second, if expropriation is found then whether India has complied with the conditions necessary to have a lawful expropriation, which includes the presence of ‘public purpose’.

In other words, by giving an ordinary meaning to the words occurring in the ‘limited-content’ expropriation formulation one can state that the expropriation provision does not preclude India from regulating for public purpose. However, the provision recognises that India can adopt regulatory measures that are expropriatory to achieve a public purpose provided compensation is paid.<sup>418</sup> Using public purpose as a criterion to determine expropriation, which is the first step, will be inconsistent with the structure of the ‘limited-content’ expropriation provision in these IIAs because such interpretation will subsume the second step into the first step.<sup>419</sup> Such subsuming will also result in a contradictory situation where expropriation is not allowed till there is public purpose and compensation, and at the same time public purpose is used to distinguish between regulation and compensable expropriation.<sup>420</sup>

Argument in favour of relying on ‘purpose’ to determine indirect expropriation even if the expropriation provision in ‘limited-content’ expropriation provision refers only to ‘effect’ and not to ‘purpose’ could be made by relying on the general principle, as part of CIL, that a state does not commit an expropriation and is not liable for adopting general regulatory measures that are commonly accepted as part of states’ police powers like the *Saluka* tribunal.<sup>421</sup> The importation of this CIL principle into ‘limited-content’ expropriation provision can be justified by relying on Article 31(3)(c) of the VCLT; and thus arguing that this is a relevant

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<sup>418</sup> See Vandevelde (2009), 296 for the argument that obligation to pay compensation for an expropriation remains no matter how big the public purpose is.

<sup>419</sup> Also see Hoffman (2008); Vandevelde (2009), 302; *Fireman’s Fund Insurance Company v Mexico*, ICSID Case No ARB (AF)/02/01, para 174; *Corn Products International v Mexico*, ICSID Case No. ARB(AF)/04/01, para 89. Also see *Siemens* tribunal, which said that purpose is a criterion to determine whether expropriation is in accordance with the IIA and not for determining whether expropriation has taken place – para 270. Very recently, in *Chemtura v Canada*, the arbitral tribunal adopted the same approach as tribunals in *Fireman Fund Insurance* and *Corn Products* – para 257.

<sup>420</sup> Also see *Azurix* tribunal, para 311. Another related critique of the *Tecmed* tribunal is that it will encourage states to adopt sweeping regulatory measures in order to further the claim for a large public benefit in order to avoid paying compensation – Vandevelde (2009), 296.

<sup>421</sup> *Saluka*, para 254-62.

rule of international law to interpret ‘*measures having effect equivalent to nationalisation or expropriation*’.

While many authorities support the right of the host state to regulate for *bonafide* public purpose even if it considerably affects foreign investment;<sup>422</sup> what is challenging is to answer whether this right has any limits. According to the ‘police power’ test it has no limits barring the limit of legitimate expectations given by the *Methanex* tribunal.<sup>423</sup> On the other hand, it has been argued that ‘*historically, police powers have never been meant to cover regulations amounting to expropriations, except perhaps in situations where there is a state of emergency or a state of necessity.*’<sup>424</sup> In other words, it is one thing to state that India has the right to adopt non-discriminatory regulatory measures for public purpose; quite different to decide how this will be applied in light of the fact that India has herself accepted restrictions on its right by signing so many IIAs. Furthermore, one needs to distinguish between those situations where India exercises regulatory power to adopt regulations in good faith even if such regulations adversely affect foreign investment from those situations where the same good faith regulations neutralise foreign investment. As per the approach adopted by the *Methanex* and *El Paso* tribunals no expropriation will be found even in the latter cases unless the regulation violates investor’s legitimate expectations or are unreasonable. However, a *bonafide* regulation that totally destroys the value of the investment should be compensated because international law does not allow putting such high burden on an individual for the benefit of the society.<sup>425</sup> Further, the very purpose of having expropriation provisions in IIAs is to ensure that if a regulation for public purpose and in accordance with due process crosses the threshold, the foreign investor should be compensated.<sup>426</sup> Many tribunals have also not supported the assertion that *bonafide* regulation for public purpose is not expropriatory. The

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<sup>422</sup> Brownlie (1990), 532; *Saluka*, para 254-62, *Methanex*, para 410, *Feldman v Mexico*, paras 103 and 112. Also see *Sedco Inc v National Iranian Oil Co, Interlocutory Award* 9 Iran US Cl. Trib. Rep. 248, 275 (1985); Sohn and Baxter (1961), 553; OECD (1967); Christie (1962), 338. Also see Wagner (1999), 517; Aldrich (1994), 609; Newcombe (2005), 26; Newcombe and Paradell (2009), 357-58; Subedi (2008), 77-78.

<sup>423</sup> Also see *El Paso v Argentina*, para 240. Prof Sornarajah (2010), 375 has argued that the formulation by the *Methanex* tribunal on ‘specific commitments’ is not supported by authority.

<sup>424</sup> Vicuna (2002), 27; also see Reinisch (2008), 437-38; Mostafa (2008), 273; Gann (1985), 379. The 1986 American Law Institutes’ Third restatement of the Foreign Relations Law, states that a ‘*state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if not discriminatory.*’ It is important to note that phrases like ‘loss of property’ and ‘economic disadvantage’ refer to those situations that are below the threshold line of substantial deprivation. There is difference between ‘economic disadvantage’ and ‘substantial deprivation’.

<sup>425</sup> Paulsson and Douglas (2004), 157. In this regard it has also been argued that it is not right to put all cost of a *bonafide* regulation on the foreign investor – see Brower II (2009). Also see Ewing-Chow and Teck (2008), 38.

<sup>426</sup> Weiler (2005), 919.

tribunal in *ADC v Hungary*<sup>427</sup> said that while a sovereign nation possesses the inherent right to regulate its domestic affairs, the exercise of this right must have its boundaries.<sup>428</sup> The tribunal recognised that the relevant IIA provided such boundaries.<sup>429</sup> The *Azurix* tribunal found the criterion that ‘*host state is not liable for economic injury that is the consequence of bonafide regulation within the accepted police powers of the state*’ insufficient to determine indirect expropriation and recognised that a legitimate measure serving public measure could give rise to a compensation claim.<sup>430</sup> The tribunal in *Pope and Talbot* stated that ‘*a blanket exception for regulatory measures would create a gaping hole in international protection against expropriation*’.<sup>431</sup> The tribunal in *Vivendi II* stated that ‘*if public purpose automatically immunizes the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose....*’<sup>432</sup>

Another complex issue in this context is how to determine which public purpose is *bonafide* and thus not compensable? The ‘limited-content’ type expropriation provision in these 57 Indian IIAs do not provide any basis to determine that a particular regulatory measure is or is not for a *bonafide* public purpose and hence compensable or not. If this determination is done by using the broadest rule that ‘any non discriminatory regulatory measure for public purpose’ is outside the ambit of expropriation, notwithstanding the effect, it will push almost all non-discriminatory regulatory purposes for public purpose implemented by following due process outside the scope of the expropriation provision making the expropriation provision in these 57 IIAs redundant.<sup>433</sup> This will violate the very object and purpose of majority of Indian IIAs, which is to provide protection to foreign investment. If determination of public purpose is made by giving deference to India, it may lead to the possibility of India invoking ‘public purpose’ to basically negate protection against expropriation to foreign investment.<sup>434</sup> This is evident from the broad interpretation given to ‘public purpose’ in Indian law. The Supreme Court of India has held that ‘public purpose’ is not a static concept<sup>435</sup> and has also

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<sup>427</sup> *ADC v Hungary*, ICSID Case No. ARB/03/16, 2 October 2006.

<sup>428</sup> *Id.*, paras 423,424.

<sup>429</sup> *Id.*

<sup>430</sup> *Azurix* tribunal, para 310.

<sup>431</sup> *Pope and Talbot*, para 99. Also see *Feldman v Mexico*, para 110.

<sup>432</sup> *Vivendi II (Compania de Aguas del Aconquija SA and Vivendi Universal v Argentine Republic)*, Award 20 August 2007, para 7.5.21. Also see *Santa Elena v Costa Rica* para 72. For criticism of *Santa Elena v Costa Rica* see Sands (2002), 203-04; Sornarajah (2004), 359.

<sup>433</sup> Also see Sornarajah (2010), 375; Kriebaum (2007), 727; Vandeveld (2009), 302.

<sup>434</sup> For more on states are free to determine what is in their public interest see – Hertz (1941), 253; Friedman (1953), 141-42.

<sup>435</sup> *Kameshwar Singh* case AIR 1963 SC 151.

said that no hard and fast definition of public purpose is possible.<sup>436</sup> It has been argued that whatever furthers the general interest of the community, as opposed to particular interest of the individuals, may be regarded as public purpose.<sup>437</sup> Indian courts have showed a good deal of deference to the legislative and executive organs of the Indian state on the matter of public purpose,<sup>438</sup> though public purpose remains justiciable.<sup>439</sup>

Will the arbitral tribunal adopt an approach of going along a spectrum where some purpose excludes expropriation and some don't?<sup>440</sup> Deciding this issue may not be easy because there is no internationally recognised 'taxonomy' of 'police powers'; although arguments have been made to develop such a 'taxonomy'.<sup>441</sup> Newcombe and Paradell characterise three categories of police power for which state's action shall remain non-compensable: (a) public order and morality – thus property seized for criminal activities shall not be expropriation – authors argue that there is a greater possibility of widespread state practice and *opino juris* with respect to police powers in core areas of criminal law;<sup>442</sup> (b) protection of human health and environment, and; (c) taxation.<sup>443</sup> However, authors also recognise problems related to developing such a taxonomy because it remains unclear to what extent can a host country use regulatory measures to dispossess investors of their investments.<sup>444</sup> Further, concepts such as public morality will differ across countries.<sup>445</sup>

The *Saluka* tribunal mentioned that international law is yet to identify comprehensibly and definitely which regulations are 'permissible' and will be accepted as falling within the police

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<sup>436</sup> *State of Bihar v Kameshwar Singh* AIR 1952 SC 252.

<sup>437</sup> Jain (2003), 1491.

<sup>438</sup> Narain (1964), 175.

<sup>439</sup> See *State of Bombay v Nanji* AIR 1956 SC 294.

<sup>440</sup> Also see Paparinskis (2011), 312

<sup>441</sup> See Newcombe and Paradell (2009).

<sup>442</sup> Newcombe and Paradell (2009), 357.

<sup>443</sup> Id, 357-62.

<sup>444</sup> Id, 359.

<sup>445</sup> One commentator has conceptualised *Methanex* test as 'method' test instead of 'purpose' test (Paparinskis 2011). The argument is that it is not the purpose behind the measure but the regulatory method of adopting the measure which is important. Thus, if a regulatory measure has been adopted following 'due process', then notwithstanding the 'effect' of the measure on foreign investment, it will not be expropriation. This conceptualisation is better than the 'purpose' based *Methanex* test because it is able to overcome problems like which public purposes are bonafide and which are not. However, even this conceptualisation raises same conceptual questions given the structure of the expropriation provision in 57 Indian IIAs that contain 'limited-content' type expropriation provision. The method test relies on due process to determine indirect expropriation whereas due process exists in these Indian IIAs is one of the criteria to determine legality of expropriation and not for the determination of whether an indirect expropriation has occurred or not.

or the regulatory power of states.<sup>446</sup> Thus, the tribunal said that it will have to determine whether the concerned regulatory measure crosses the line that separates regulation from expropriation.<sup>447</sup> As per this, the *ad hoc* arbitral tribunals will have the discretion to determine whether a contestable regulatory measure is part of ‘police power’ of the state and hence a regulation or an expropriation.<sup>448</sup> However, this gives much discretion to arbitrators to decide complex value laden question of what *bonafide* public purposes are and what are not for the state concerned (India) with the discretion to replace the host states’ (India) public purpose with their own notion of public purpose without having specific and local knowledge about the issue at hand that a national regulator will have. Such complex questions are often resolved by national judges in national courts. Even here, it is now argued in India that judges should not step into the shoes of the executive to decide policy issues.<sup>449</sup>

Same analysis applies to the proportionality test.<sup>450</sup> The difference between ‘police power’ test and ‘proportionality’ test is that in the former the assessment will not be in comparison with the effect of the measure, whereas in the latter, the comparison will be with the effect of the measure on the investment in question. Furthermore, the proportionality test runs the risk of very important public policy objectives being trumped by interests of investors in situations where the arbitral tribunal is of the view that costs of the effect outweigh the benefit. Proportionality test has been proposed in ITA as one of the solutions to balance investment protection with host country’s regulatory power and hence further the legitimacy of the international investment law regime.<sup>451</sup> The argument to use proportionality test is based on developing the international investment regime as a constitutional and global administrative regime having coherent and universal standards of investment protection.<sup>452</sup> It has been argued that the claim to use proportionality analysis in ITA is at odds with other perspectives that look at IIAs as ‘*the entrenchment of one legal point of view against an opposing position.*’<sup>453</sup>

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<sup>446</sup> *Saluka investments*, para 263. Also see Fortier and Drymer (2004), 299; Subedi (2008), 164-72; Mostafa (2008), 272-73.

<sup>447</sup> *Id.*, 265.

<sup>448</sup> Also see Montt (2009), 281 who argues that investment treaty tribunals must review the state’s public interest ‘with heightened scrutiny’.

<sup>449</sup> See the lecture of Chief Justice of India SH Kapadia, ‘*Judges do not have the Competence to make Policy Choices and Run Administration*’ available at <http://www.indianexpress.com/news/judges-do-not-have-the-competence-to-make-policy-choices-and-run-administration/777495/0>.

<sup>450</sup> Paulsson (2005).

<sup>451</sup> Sweet and Grisel (2009), 131; Schill (2011), 100. On this point also see Mills (2011), 500-01.

<sup>452</sup> Schill (2009), 108. On this point, also see Mills (2011), 480-81.

<sup>453</sup> Pirker (2011). Also see Mills (2011), 469 for an insightful discussion on this perspective.

The use of the principle of proportionality in determining indirect expropriation is problematic given the unique system of resolving investor–state disputes in ITA – use of private law adjudicative model to settle public law questions. In other words, in the Indian domestic constitutional arrangement, a proportionality test shifts the burden of decision making from policy makers to the judges of the High Courts and the Supreme Court of India who assess whether the policy makers have found the balance between competing claims.<sup>454</sup> These judges are embedded in the Indian system and understand the Indian social and political context in which they operate. However, the same does not hold true for the ITA tribunals who are not embedded in the political and social system of the communities whose disputes they decide<sup>455</sup> and have no or inadequate knowledge of the overall legal, political and social context related to the dispute.<sup>456</sup> This position makes them less suitable to adopt an intrusive review of the kind contained in a proportionality analysis.<sup>457</sup> Furthermore, other factors such as the *ad hoc* nature of the ITA tribunals; the fact that arbitrators are appointed by the parties influenced by the positions taken by them in other arbitrations and academic writings;<sup>458</sup> issues related to conflict of interest and independence such as an individual acting as an arbitrator and a counsel in another dispute at the same time or wishing to win future appointments as arbitrators by safeguarding their reputation amongst investors or host states;<sup>459</sup> pose questions on the claim that ITA tribunals should wield power related to exercising discretion by using the test of proportionality on issues of public purpose.<sup>460</sup>

### Presence of NPM provision

Another difficulty surfaces when one takes into account the Non Precluded Measures (NPM) (the NPM provisions are discussed in detail in chapter 6; however here a brief introduction is useful) in these 57 IIAs that contain ‘limited-content’ type expropriation provision. NPM

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<sup>454</sup> See Pirker (2011).

<sup>455</sup> Burke-White and Von Staden (2011), 323; Lowe (2002), 464-65. Even those who advocate the use of proportionality test in ITA accept this criticism of the proportionality test – Kingsbury and Schill (2010), 104. The response to overcoming these problems is not very satisfactory as they mostly relate to adopting the proportionality test well and using it because other alternatives are not useful.

<sup>456</sup> It is also argued that ITA arbitration is heavily influenced by the style and culture of ICA and the arbitrators are not grounded in public international law or trained to settle public law questions – see Walde (2009), 725-26; Paulsson (2008).

<sup>457</sup> Burke-White and von Staden (2011), 323.

<sup>458</sup> Pirker (2011).

<sup>459</sup> Van Harten (2007), 167-74. Also see Walde (2009), 731-32.

<sup>460</sup> In this regard see the arguments of having a deferential standard of review - Burke White and Staden (2010), 283. Also see Kurtz (2010).

provisions in an IIA (starting with words like – ‘*nothing in this agreement precludes...*’) provide the regulatory latitude to host countries to deal with threats to important national interests notwithstanding its inconsistency with all other IIA provisions.<sup>461</sup> For example, the NPM provision in IIAs containing ‘limited-content’ type expropriation formulation have permissible objectives like essential security interest, public order, protection of human and animal health etc. The presence of these permissible objectives in the NPM provisions in these Indian IIAs makes it clear that India and its treaty partners have agreed to certain situations in which they can deviate from the treaty provisions including expropriation without incurring any liability. In other words, since India has already expressed the non-investment values for which it can deviate from its treaty obligations, it will be inappropriate for an arbitral tribunal to second guess these purposes as part of the expropriation analysis.

The difficulty due to the presence of the NPM provision is more profound in case of the proportionality test. Let us assume that India adopts a measure to protect its economy at the time of crisis. Further, assume that this measure results in ‘substantial deprivation’ of the foreign investment. This foreign investor alleges expropriation whereas India counter-argues that its measure has been adopted to save its economy. In this case, a proportionality test to determine indirect expropriation will mean that the arbitral tribunal will perform the three steps, mentioned above, including the final step of weighing and balancing the regulatory measure with the effect on investment and find an expropriation only if the adverse impact on investment outweighs the benefits achieved from the regulatory measure.

Let us assume that the tribunal finds an expropriation. India can now argue that this violation of the IIA is excused under the NPM provision, which allows India to adopt measures for the protection of its ‘essential security interest’ provided it is necessary to do so (assuming ‘necessary’ is the nexus requirement)<sup>462</sup> notwithstanding anything contained in the treaty. Let us also assume that India is able to convince the tribunal that its regulatory measure to protect the economy is an ‘essential security interest’ (ESI). Next step for the tribunal will be to show that this measure is ‘necessary’.

This is where the conceptual difficulty will arise. How will the arbitral tribunal determine that the measure adopted by India, even if it violates the expropriation provision, is necessary to

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<sup>461</sup> Vandevelde (2009), 178. Also see Salacuse (2010), 343. Also see Newcombe (2011), 356-57.

<sup>462</sup> See chapter 6 on NPM for more details.

achieve ESI? The tribunal has two options: first, interpret necessary using the least restrictive alternative test, and second, interpret necessary using the proportionality test where the least restrictive alternative test is one of the steps, as mentioned above. In both situations, the arbitral tribunal will only be duplicating the analysis already undertaken to find out whether indirect expropriation occurred and will result in the same finding. In other words, if the arbitral tribunal didn't find India's measure necessary as part of the proportionality test, then it will obviously not find it necessary under the NPM provision either; and similarly, if the measure was not proportionate under the expropriation analysis it will obviously not be proportionate under the NPM provision.<sup>463</sup>

One exception is possible to the analysis offered above. There could be a possibility of undertaking a proportionality analysis for a different permissible objective in the NPM provision. For example, the tribunal might have carried out the proportionality test under the expropriation provision with public health as the purpose whereas in the NPM provision the permissible objective could be public order. In such a situation, India's measure will be judged against two different non investment values: once under expropriation and then under the NPM provision. It is possible that measure could disallowed under the expropriation provision but allowed under the NPM provision — in other words, the measure may not be proportional to public health and hence a violation of the expropriation provision, but may be found proportional to public order on the basis that public order is broader than public health. However, even here there is no doctrinal basis for an arbitral tribunal to undertake such a balancing act as part of the expropriation provision when India and its treaty partner intended to have, if at all, such balancing as part of the NPM provision.

The use of 'police power' test and proportionality test in the expropriation provision runs the risk of negating the very purpose and presence of the NPM provisions in the IIAs having the 'limited-content' expropriation provision. The NPM provisions in these IIAs exist for the purpose of finding a safe haven for those regulatory measures that violate the expropriation provision.<sup>464</sup> Hence, both versions of the 'purpose test' violate the 'effective treaty

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<sup>463</sup> In this regard also see Kriebaum (2007) who has argued for a proportionality test for expropriation clauses in IIAs different from the one adopted in *Tecmed* and more close to the ECHR jurisprudence. However, even here the same issues discussed in the chapter will arise.

<sup>464</sup> This problem could have arisen in *LG&E v Argentina* because Article XI of the US-Argentina IIA contained the NPM provision. The LG&E tribunal endorsed the proportionality test used by *Tecmed* – para 195; although it found no expropriation had taken place because Argentina's measures didn't had a substantive effect on the



interpretation’ principle, which is recognised as part of the ‘good faith’ obligation of Article 31(1) of the VCLT.<sup>465</sup>

### Context

Another important issue is related to the context of these 57 IIAs. The *Tecmed* tribunal relied on ECHR jurisprudence to introduce the proportionality test. However, the normative values that bind EC cannot be cross applied to the network of Indian IIAs, which have different normative values and goals — hence a different context. Such cross regime application might serve the normative value of stopping the fragmentation of international law as some scholars have argued,<sup>466</sup> however, will violate the requirement of interpreting a treaty in its ‘context’. For example, Kurtz, in rejecting the proportionality test to interpret ‘necessary’ in Non Precluded Measures (NPM) in IIAs, has argued that the use of proportionality test in the context of EC is to further the normative goal of positive integration of EC and is in fact a part of judicial activism due to the failure of the legislative arms of the EC to further this goal.<sup>467</sup> No such normative goal is to be pursued by IIAs. It is important to note that the European Convention on Human Rights recognises right to property as a human right. Thus, use of proportionality test as a means to balance state’s action with curtailment of this right may be justified given the specific context. Further, protocol to the convention for the protection of human rights and fundamental freedoms recognises provides ... *the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties*’. This also provides a clear textual basis to undertake a test that examines whether the measure adopted by the state to achieve the aim, which subverts the right to property is necessary or not.<sup>468</sup> However, none of these things are present in the ‘limited-content’ expropriation provision and hence the ‘contextual’ difference.<sup>469</sup> Another key distinction between ECHR and the ‘limited content’ type expropriation provision is that the European

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investment – paras 198-200. Further, it used the CIL notion of necessity to interpret Article XI (NPM provision) and not the proportionality test, which would have been more close to the language of Article XI.

<sup>465</sup> See Qureshi (2006), 13-14; Gardiner (2008), 159-61.

<sup>466</sup> Kingsbury and Schill (2010), 104.

<sup>467</sup> Kurtz (2010), 373. Also see Xiuli (2006), 637 who has argued that in EU law the principle of proportionality is becoming a constitutional principle of Europe. Also see Maduro (1998). For a detailed and up to date discussion on proportionality test in ECJ see Harbo (2010).

<sup>468</sup> Id.

<sup>469</sup> In this regard it has also been argued that there was neither textual basis not basis in CIL for the *Tecmed* tribunal to use the proportionality test – Mostafa (2008), 285.

Convention on Human Rights provides the protection of the European Court of Human Rights after domestic remedies have been exhausted.<sup>470</sup> This is not the case with Indian IIAs where the foreign investor can bring disputes against Indian even without exhausting domestic remedies.

It is also important to note the key methodological variation in the proportionality test as applied by the *Tecmed* tribunal. In the ECHR jurisprudence, cited by this tribunal, the proportionality test was used to decide whether an expropriation was justified and not to find out whether an expropriation had occurred.<sup>471</sup> Another notable point is that the above tribunal justified the use of proportionality to determine indirect expropriation based on the justification given in the ECHR jurisprudence that since non nationals would not have played a role in the election of the measures adopted by the host state thus nationals should bear a greater burden than the non-nationals for the regulatory measure adopted.<sup>472</sup> David Schneiderman has challenged this approach arguing that use of democratic theory to place foreign investors at par with enfranchised citizens is inappropriate.<sup>473</sup> Empirical studies show that foreign corporations (vehicles of foreign investment) influence political process even if they are not able to cast vote.<sup>474</sup> There are many examples in India of foreign corporations lobbying and influencing for changes in policy like recently global pharmaceutical companies made a representation to the Prime Minister of India's Office (PMO) in August 2010 to review India's patent laws with the objective of increasing the term of patent protection beyond 20 years and also bring about other changes.<sup>475</sup> This representation resulted in the PMO issuing a letter to different ministries asking for their views on this matter, notwithstanding the vociferous opposition by the public health groups.<sup>476</sup> There have been instances of multinational media firms lobbying for changes in India's policy on satellite television.<sup>477</sup> Thus, foreign corporations can exert influence on the policy making process and on the power centers and thus to compare them with enfranchised citizens whose property might have been taken away by the state will be erroneous.

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<sup>470</sup> Pirker (2011).

<sup>471</sup> Kriebaum (2007), 728.

<sup>472</sup> Id.

<sup>473</sup> For an elaborate critique see - Schneiderman (2010), 909.

<sup>474</sup> Id.

<sup>475</sup> PMO Circulates Note on IPR Tweaks for Drug MNCs available at [http://articles.economictimes.indiatimes.com/2010-08-19/news/27571507\\_1\\_indian-drugmakers-indian-patent-act-patent-claims](http://articles.economictimes.indiatimes.com/2010-08-19/news/27571507_1_indian-drugmakers-indian-patent-act-patent-claims).

<sup>476</sup> Id.

<sup>477</sup> DTH Operators, MNCs Lobby for Open Sky Policy available at <http://www.financialexpress.com/news/dth-operators-mncs-lobby-for-open-sky-policy/765363/0>.

### 3.2.2 'Content-Indicative' type – Interpretation

As mentioned in section 3.1 on 'Anatomy', 'content-indicative' type expropriation formulation implies that expropriation provision in these IIAs states what is indirect expropriation and provide detailed criterions on how to determine indirect expropriation. It has been argued that much of the controversy surrounding the debate between regulation and expropriation has arisen due to IIAs not providing proper definition of these terms.<sup>478</sup> In this sense, the 'content-indicative' expropriation formulation is more definite and clear on when an indirect expropriation takes place.

Before we look at these IIAs in detail, it is important to point out that they are based on and inspired from the expropriation provision present in the 2004 US Model IIA.<sup>479</sup> Further, it is important to keep in mind that the 'content-indicative' expropriation provision do not provide the detailed criterions to determine indirect expropriation as part of the IIA but as a separate protocol or annex, which reflects the shared understanding of the parties regarding the interpretation of expropriation. For example, Article 5 of the India-China IIA provides the same expropriation provision as is contained in the rest 57 'limited-content' indicative IIAs. However, the India-China IIA also contains a protocol that gives the shared understanding of India and China regarding the interpretation of the expropriation provision clearly stating that this protocol is part of the agreement (IIA).<sup>480</sup> The same is the case with other 'content-

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<sup>478</sup> Muchlinski (2007).

<sup>479</sup> For more on the expropriation provision in the US Model 2004 IIA see Vandevelde (2009), 478-84.

<sup>480</sup> The Protocol on India-China IIA states – '*With regard to the interpretation of expropriation under Article 5, the Contracting Parties confirm their shared understanding that:*

*1) A measure of expropriation includes, apart from direct expropriation or nationalization through formal transfer of title or outright seizure, a measure or series of measures taken intentionally by a Party to create a situation whereby the investment of an investor may be rendered substantially unproductive and incapable of yielding a return without a formal transfer of title or outright seizure.*

*2) The determination of whether a measure or a series of measures of a Party in a specific situation, constitute measures as outlined in paragraph 1 above requires a case by case, fact based inquiry that considers, among other factors:*

*i) the economic impact of the measure or a series of measures, although the fact that a measure or series of measures by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that expropriation or nationalization, has occurred;*

*ii) the extent to which the measures are discriminatory either in cope or in application with respect to a Party or an investor or an enterprise;*

*iii) the extent to which the measures or series of measures interfere with distinct, reasonable, investment-backed expectations;*

*iv) the character and intent of the measures or series of measures, whether they are for bona fide public interest purposes or not and whether there is a reasonable nexus between them and the intention to expropriate.*

*3) Except in rare circumstances, non-discriminatory regulatory measures adopted by a Contracting Party in pursuit of public interest, including measures pursuant to awards of general application rendered by judicial bodies do not constitute indirect expropriation or nationalization'.*

indicative' type expropriation provisions in all 16 IIAs barring the India-Saudi Arabia. In this IIA, the detailed factors to determine indirect expropriation are part of the expropriation provision. The discussion below, relying on Article 31(2)(a) of the VCLT, which states '*any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty*' will interpret the expropriation provision in these IIAs.<sup>481</sup>

India's IIA with Singapore, entered in 2005, was the first IIA to have an expropriation provision like this.<sup>482</sup> Since this IIA, 15 more Indian IIAs have been signed with such formulation of the expropriation provision. However, it is important to note that not all Indian IIAs post India-Singapore IIA contains a 'content-indicative' type expropriation provision. In fact, out of the 30 IIAs starting with the India-Singapore IIA, entered by India during this period, 16 contain similar expropriation provision like this. Thus, this practice of having detailed expropriation provisions has not been consistently followed. The significance of some of the newer Indian IIAs having such expropriation provision is that it reveals one of the very few changes that India has made due to the global increase in the number of investor-state investment treaty disputes involving expropriation and the attendant concern of

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<sup>481</sup> See the debate on whether such protocols fall under Article 31(2)(a) or under Article 31(1) of the VCLT. It is also stated that the substance is more important than the form or classification - Gardiner (2008), 213. Also see Qureshi (2006), 19-20.

<sup>482</sup> The Annex of the India-Singapore IIA states the following on determination of indirect expropriation - *The Parties confirm the following understanding with respect to the interpretation and/or implementation of Chapter 6 on Investment of the India-Singapore Comprehensive Economic Cooperation Agreement (the 'Agreement')*:

(a) *Article 6.5 of the Agreement is intended to reflect customary international law concerning the obligations of States with respect to expropriation;*

(b) *a measure of expropriation includes, apart from direct expropriation or nationalisation through formal transfer of title or outright seizure, a measure or series of measures taken by a Party that has an effect equivalent to direct expropriation or nationalization, without a formal transfer of title or outright seizure;*

(c) *an action or series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment;*

(d) *the determination of whether a measure or series of measures of a Party in a specific factual situation, constitute measures as referred to in paragraph (b) above requires a case-by-case, fact-based inquiry that considers, among other factors:*

(i) *the economic impact of the measure or series of measures, although the fact that a measure or series of measures by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that measures having effect equivalent to nationalization or expropriation, has occurred;*

(ii) *the extent to which the measure or series of measure interfere with distinct, reasonable, investment-backed expectations;*

(iii) *character of the measure or series of measures, including inter alia, their intent, objectives, purpose, and degree of nexus between the measures and outcome or effects that forms the basis of the expropriation claim; and*

(e) *except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied for legitimate public welfare objectives such as health, safety and the environment, do not constitute measures having effect equivalent to nationalization or expropriation.*

curtailment of regulatory power due to broad and undefined expropriation provisions. However, India has basically mirrored this kind of expropriation provision from the 2004 US Model IIA because the US model provided a readymade formulation that could be directly incorporated<sup>483</sup> although there are subtle differences discussed below. However, India has not carefully thought this through, which is illustrated by the fact that its practice is random in having this type of provision in some IIAs and not in others. Further, as it will be discussed later in the chapter, this type of expropriation provision is also not consistent with the manner in which India understands expropriation domestically.

13 IIAs out of the 16 that contain the ‘content-indicative’ formulation explicitly recognise that indirect expropriation results from a measure or a series of measures that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure. Thus, according to these IIAs, indirect expropriation occurs when the state’s measures have effects similar to a formal transfer of title or outright seizure (direct expropriation). Some of these IIA go a step forward and even specify what is meant by effect equivalent to direct expropriation. For example, Ad Article 5 of the Protocol to the India-China IIA specifies that measures or a series of measures that create a situation whereby ‘*the investment of an investor may be rendered substantially unproductive and incapable of yielding a return ...*’ is a measure of expropriation.

The India-Saudi Arabia IIA is the only IIA in this category that does not spell out indirect expropriation as clearly as the rest 13 IIAs. Article 4.2 of the India-Saudi Arabia IIA states that ‘*to determine whether an action or a series of actions is tantamount to expropriation (indirect expropriation), a case by case fact based inquiry shall be made in accordance with the provisions of this agreement and principles of customary international law...*’. Thus, this IIA although recognising that an action or a series of actions could tantamount to expropriation; does not explicitly mention that indirect expropriation implies a situation where state’s action or series of measures have an effect equivalent to direct expropriation without formal transfer of title, etc.

Some of the IIAs [India-Singapore (Expropriation Annex 3 (1) (c)); India-Malaysia (Annex 10-10; India-Korea (Annex 10-A)] out of the 13 that explicitly provide for what does indirect

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<sup>483</sup> Two Finance Ministry Officials interviewed told this to the researcher.

expropriation mean, also make it clear that an action or a series of actions do not constitute expropriation unless it interferes with a tangible or intangible property right or property interest in an investment. This provision is present in the 2004 US Model IIA as well. It has been argued that this language in the 2004 US Model IIA was inserted in response to arguments made in some of the NAFTA cases like *Pope and Talbot* and *Methanex* that reduction or elimination of market share could constitute expropriation.<sup>484</sup>

### *Pointer to proportionality test*

Although 13 IIAs mention that indirect expropriation involves situations that have an effect equivalent to direct expropriation; they provide other criteria, along with ‘effect’ in determining expropriation. All the 16 IIAs contain at least three factors:

- a) Economic impact of the measure; though it is stated that simply because a measure has an adverse effect on the economic value of an investment, standing alone, will not establish that indirect expropriation has taken place.
- b) The extent to which measures adopted by India interfere with distinct, reasonable, investment-backed expectations.<sup>485</sup> This feature has been blindly copied from the 2004 US Model IIA where it is inspired from the US national law. The US Supreme Court in *Penn Central Transportation Company v City of New York*<sup>486</sup> had identified this factor as one of the factors to determine regulatory takings. The expropriation provision in the 2004 US Model IIA is an attempt by the US to internationalise its national law.<sup>487</sup> India has adopted this US internationalisation in the IIAs containing the ‘content-indicative’ type expropriation formulation although the Indian law on takings (discussed below) nowhere recognises such a factor in determining expropriation. In fact, India’s investment treaty negotiators do not fully know that this provision goes beyond Indian domestic law pointing the lack of technical

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<sup>484</sup> Vandevelde (2009), 481.

<sup>485</sup> For more on investor expectations and expropriation see *Metalclad v Mexico*, para 107; *Azurix v Argentina*, paras 316-22; *Thunderbird v Mexico*, para 147. Also see Poulsson and Douglas (2004), 156 who support this as part of expropriation measure; on the other hand Sornarajah (2010), 375 has argued that this test to determine expropriation is without any authority. Also see other studies on this – Siwy (2007), 355-77; Snodgrass (2006), 1; Fietta (2006).

<sup>486</sup> *Penn Central Transportation Company v City of New York*, 438 US 104, 57 L Ed 2d 631. Also see other US cases on how US law has developed on the issue of expropriation – *Miller v Schoene* 276 US 272 (1927); *Pennsylvania Coal Co v Mahon* 260 US 393 (1922).

<sup>487</sup> See Vandevelde (2009), 481.

expertise as discussed in the introductory chapter. Further, as discussed in the chapter on FET, the doctrine of legitimate expectations has limited role in Indian law. Although this principle has been supported by some arbitration tribunals, it is important to question the usefulness of a standard like this to determine expropriation. This principle is often used by arbitral tribunals to determine FET violations. Thus, using this standard for expropriation unnecessarily conflates two different concepts of expropriation and FET.<sup>488</sup> Determination of expropriation is primarily about deprivation and not about investor's expectations.

c) The character of the measure.

In addition to these three, some IIAs [Ad Article 5 (1) (2) (ii) of the India-Trinidad and Tobago; Ad Article 5 (1) (2) (ii) of the India-China; and Ad Article 5 (1) (2) (ii) of the India-Iceland] also provide another factor – the measure adopted should be non discriminatory.

The presence of these three factors implies that none of these IIAs provide for the 'substantial deprivation' test to determine indirect expropriation because the focus is not just on the impact of the measure but also on the character and the purpose of the measure. Thus, these IIAs conceive those situations where an investor might have suffered severely; however, the measure will still not be indirect expropriation because of its character and purpose. This refers to adopting a test to determine indirect expropriation, which will take into account not just the impact of the measure on foreign investment but also the character and the purpose of the measure such as police power and the proportionality test. However, the proportionality test appears to be more suitable because the formulation suggests weighing and balancing effect of the measure on the investment with the purpose behind the adopted measure to find out indirect expropriation. The use of the proportionality test is further strengthened by the clear language of some of these IIAs. For example, Protocol on Article 5 (d) of the India-Brunei Darussalam IIA states that one of the factors in assessing the character of the measure is to consider the '*degree of nexus between the measures and outcome or effects that forms the basis of the expropriation claim*'.

*'Except in rare circumstances' clause*

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<sup>488</sup> *Tecmed*; Coe and Rubins (2005), 665; Mostafa (2008), 286. Also see White (1961), 6; Weiler and Laird (2008), 259.

‘Content-indicative’ expropriation provisions also mention that - *‘except in rare circumstances non-discriminatory regulatory measures adopted by a Contracting Party in pursuit of public interest, including measures pursuant to awards of general application rendered by judicial bodies do not constitute indirect expropriation or nationalization’*.<sup>489</sup>

This clause makes it clear that India can adopt genuine regulatory measures to pursue legitimate public welfare objectives such as public health and environment.<sup>490</sup> A clause like this is present in all ‘content-indicative’ expropriation provisions barring India-Japan IIA.

However, in some of the IIAs this clause is not prefaced by ‘except in rare circumstances’ [India-Trinidad Tobago (Ad Article 5(3); India-Saudi Arabia (Article 5(3); India-Malaysia (Annex 3)]. The significance behind not having this phrase as the preface is that it means that in no situation a legitimate measure adopted by India for a public welfare objective shall amount to expropriation. This formulation endorses the ‘police power’ test. However, this is problematic for two reasons. First, this provision signifying the ‘police power’ test will be hard to be reconciled with those provisions in the expropriation provision that provide for a proportionality test. For example, in India-Trinidad and Tobago IIA, Paragraph 2 of the Annex on Expropriation provides for the proportionality test in determining whether a measure or a series of measures constitutes indirect expropriation; and at the same time Paragraph 3 states that non discriminatory regulatory actions to protect legitimate public welfare objectives do not constitute expropriation without being prefaced by the phrase ‘except in rare circumstances’. Second, such a broad provision swings the pendulum too far in India’s favour and subject to misuse.

Few IIAs like the India-Brunei Darussalam IIA [give the meaning of ‘except in rare circumstances’. Ad Article 5 (d) of the India-Brunei IIA states that ‘except in rare circumstances’ implies that *‘measures are so severe in light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith’*. Thus, this formulation states that the measure adopted by India will have to be assessed against the

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<sup>489</sup> This clause in some of the Indian IIAs is again inspired from the 2004 US Model IIA’s ‘Annex on Expropriation’, which, inter alia, provides – *‘except in rare circumstances non-discriminatory regulatory actions by a Party that are designed and applied for legitimate public welfare objectives such as health, safety and the environment, do not constitute measures having effect equivalent to nationalization or expropriation’*. For a discussion on this in the 2004 US Model IIA see Vandevelde (2009), 482-83. This formulation in the US Model IIA has also been criticised – see Paparinskis (2011), 319-22. Also see Ryan (2008), 756-57.

<sup>490</sup> See Moloo and Jacinto (2011), 37.



purpose for which it has been adopted and if the adverse effect of the measure (on foreign investment) outweighs the purpose (benefits of the measure), then the measure will be viewed as non reasonable and not adopted in good faith. Similarly, Annex 10 A 3 (b) of the India-Korea IIA states that ‘except in rare circumstances’ implies ‘*when measures are extremely severe or disproportionate in light of its purpose and effect*’. Thus, if India adopts a regulatory measure for a public welfare objective under the ‘except in rare circumstances’ clause, then whether this measure is expropriatory or not will depend on whether the benefits of the measure are severely disproportionate with the effect of the measure on foreign investment. In order to determine this, the arbitral tribunal will have to use the test of proportionality.

Problem might arise in interpreting ‘except in rare circumstances’ in those ‘content-indicative’ expropriation provisions that do not define this phrase. One interpretation of this clause could be by using the proportionality test. It can be argued that ‘except in rare circumstances’ means that India’s regulatory measure adopted for public welfare objectives shall not be expropriatory except in situations where the costs of the adverse effect of the measure on foreign investment outweigh the benefits of the measure. In other words ‘rare circumstances’ can be defined as those circumstances where costs of the effect exceed the benefits of the measure. Another interpretation could be that ‘rare circumstances’ refers to situations that may arise rarely and hence most of the regulatory measures adopted by India will not be expropriatory. In other words, this interpretation will tilt more towards the ‘police power’ test and less to the proportionality test.

### *Intention to Expropriate*

Seven IIAs, out of these 16 IIAs, focus on intent. Thus, as per Ad Article 5 (2) (iv) of the India-China IIA, measure or a series of measures to be expropriation should have been taken intentionally by the state. The same is the case in India- Trinidad and Tobago (Ad Article 5 (2) (iv)); India-Iceland (Ad Article 5 (2) (iv)); India-Syria (Ad Article 5 (2) (iv)); India-Jordan (Ad Article 5 (2) (iv)); India-Mozambique (Ad Article 5 (2) (iv)); India-Senegal (Ad Article 5 (2) (iv)). In other words, if India adopts a regulatory measure that renders the foreign investor’s investment substantially unproductive or incapable of yielding any return,

it will not be indirect expropriation if India can show that it did not have the intention to do so.

Such formulation is certainly useful from the perspective of India's regulatory power as India will not incur any liability for indirect expropriation even if its regulatory measure has an effect equivalent to direct expropriation provided the measure was adopted for a genuine regulatory purpose and not with the intention to create such a situation for the investor. However, this formulation swings the pendulum too far in favour of India's regulatory power and is subject to misuse. It provides an opportunity to cover up expropriatory measures as not intended. In other words, India can adopt expropriatory measures and when impugned could always argue that it never intended to expropriate. Thus, this formulation does not balance India's regulatory power with foreign investment protection. Furthermore, a formulation that focuses on intent is also inconsistent with the established principle of 'objective responsibility' of a state in public international law.<sup>491</sup> In other words, state's responsibility in international law is to be fixed on the basis of the result of the action and not the intent behind the action.<sup>492</sup> The same argument has been made in context of expropriation of foreign property<sup>493</sup> with one author explicitly stating that lack of intent cannot be a defence to a claim of expropriation.<sup>494</sup>

### *Issuance of Compulsory Licenses and Expropriation*

Another key provision in four 'content-indicative' expropriation provisions, inspired from Article 6.5 of the US Model IIA, is a specific mention that the expropriation provision shall not apply with respect to the grant of compulsory licenses (CL) concerning intellectual property in accordance with the TRIPS Agreement (Article 92.5 of India-Japan IIA; Article 10.7 (6) of India-Malaysia IIA; Article 10.12 (6) of India-Korea IIA; Article 6.5 (6) of India-Singapore IIA).<sup>495</sup> While India-Malaysia and India-Japan IIAs only talk about the non

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<sup>491</sup> Brownlie (2008), 437.

<sup>492</sup> Id., 441; Friedman (1953), 142.

<sup>493</sup> Reisman and Sloane (2003), 115; Christie (1962); McLachlan *et al* (2007), 301. Also see *Metalclad*, para 111; *Waste Management v Mexico*, Award dated 30 April 2004 (Case No ARB(AF)/00/3) 10 ICSID Reports, para 79. For the view that intent of the state can be used as a criterion for determining regulatory expropriation – see – Byrne (2000), 89.

<sup>494</sup> Newcombe (2005), 20.

<sup>495</sup> For further discussion on compulsory licenses and expropriation in IIAs see - Correa (2004), 331; Gibson (2010), 358; Ranjan (2008), 72.

applicability of the expropriation provision in the situations of issuance of CL, India-Korea and India-Malaysia go beyond this and also exempt the application of expropriation provision to revocation, limitation or creation of intellectual property provided such revocation, limitation and creation is consistent with the TRIPS agreement. In other words, these two IIAs provide additional regulatory flexibility to India to revoke intellectual property protection by means not just limited to issuance of CL but also other means such as cancelling intellectual property protection provided such revocation is consistent with the TRIPS agreement.

#### *Problems related to use of proportionality test in 'content-indicative' expropriation*

The use of proportionality test in the expropriation provision in these 16 IIAs containing the 'content-indicative' expropriation provision will pose a conceptual problem when one reads these IIAs as a whole. This conceptual problem will arise because of the presence of the NPM provision for reasons that have been discussed above in context of using proportionality test in those IIAs that contain 'limited-content' type expropriation provision.

#### 3.2.4 Regulatory or Indirect Expropriation in Indian law

This section will discuss how expropriation is understood in Indian law. This will provide useful insights to India's treaty practice on expropriation. In the Indian context, the journey of 'right to property' in the Indian Constitution from being a fundamental right<sup>496</sup> when the Constitution was adopted in 1950 to a constitutional right in 1978 has been riveting.<sup>497</sup> Right to property was a fundamental right till 1978. The period from the adoption of the Constitution till 1978 saw six amendments to right to property exhibiting a tussle between the judiciary and the parliament on various issues like what amounted to deprivation of property; the question of compensation and also other constitutional issues like whether the parliament has the power to amend fundamental rights – discussing these issues is beyond the scope of

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<sup>496</sup> The Indian Constitution puts certain rights on a higher pedestal such as fundamental rights, which cannot be taken away even by the legislature; whereas constitutional rights can be interfered by the legislature though it is available against executive interference.

<sup>497</sup> See Tripathi (1972), 211-306; Singh (2008), 273-301; Allen (2007), 193; Austin (1999); Deva (2009), 583; Narain (1966), 199; Ganguly (2006), 489.

this work.<sup>498</sup> The tussle on the issue of compensation is dealt in Section 3.3. Finally in 1978, the Parliament passed the 44<sup>th</sup> amendment and deleted right to property from the list of fundamental rights as well as from the chapter on fundamental rights and inserted Article 300A - '*No person shall be deprived of his property save by authority of law*'. The significance of degrading right to property from fundamental right status to a constitutional right is that the right will be available against executive interference but not against legislative interference.<sup>499</sup> Supreme Court of India has made it clear that the executive cannot deprive a person of his property without the authority of 'law', which means '*an act of parliament or of a state legislature, a rule, or a statutory order, having the force of law, that is positive or state-made law*'.<sup>500</sup> The moot question is when it can be said that a person has been 'deprived' of his property. In order to fully comprehend this question one will have to briefly understand the jurisprudence on right to property that started to emerge immediately after the adoption of the Constitution of India and the several amendments that were made to right to property.

Article 31(1) and 31(2) (related to right to property as a fundamental right) as originally enacted were in the following terms:

- (1) *No Person shall be deprived of his property save by authority of law.*
- (2) *No property, movable or immovable, including any interest in, or in any company owning any commercial or industrial undertaking, shall be taken possession of or acquired for public purposes under any law authorising the taking of such possession or such acquisition, unless the law provides for compensation for the property taken possession of or acquired and either fixes the amount of the compensation, or specifies the principles on which, and the manner in which, the compensation is to be determined and given.'*<sup>501</sup>

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<sup>498</sup> This tussle can be loosely characterised as a tussle between Executive and Parliament's social and economic programme in a newly independent under developed India with judiciary's 'protection of private property' mindset. See Sathe (1971), 1873; Allen (2007), 193-203; Deva (2008), 599-601.

<sup>499</sup> Singh (2008), 845. On this also see Sathe (1980), 97

<sup>500</sup> *Bishambhar DC Mohan v State of UP* AIR 1982 SC 33; Singh (2008), 845. Also see *State of West Bengal v Vishnunarayan & Associates* (2002) 4 SCC 134.

<sup>501</sup> The Article also had sub clauses (3), (4), (5) and (6), which are not mentioned here – See Singh (2008), 274-275.

This was interpreted by the Supreme Court of India in early 1950s in *Dwarkadas v Sholapur Spinning and Weaving Co.*<sup>502</sup> In this case, the Supreme Court recognised that state's power to eminent domain was subject to three conditions – 1) legislative sanction as a prerequisite for the exercise of the power; 2) deprivation can only be for public purpose; and 3) payment of compensation for compulsorily taken property. The issue of compensation is discussed along with the compensation requirement as part of the lawful expropriation later in the chapter. The discussion here will focus on the issue of 'deprivation'. It was further held in this case that 'acquisition' and 'taking possession of' given in clause (2) should have the same meaning as 'deprivation' given in clause (1).<sup>503</sup> On this basis, the court held that protection of property is against 'taking' away not just with respect to two forms of taking – acquisition and requisition - but also by other restrictions.<sup>504</sup> The correct approach, according to Justice Mahajan should be this: '*what in substance is the loss or injury caused to the owner and not the manner and method has been adopted by the state in taking the property*'.<sup>505</sup> The court also held an abridgement could be so substantial as to amount to deprivation.<sup>506</sup> One of the judges in the case said - '*by substantial deprivation I mean the sort of deprivation that substantially robs a man of those attributes of enjoyment which normally accompany rights to, or an interest in, property. The form is unessential. It is the substance that we must seek*'.<sup>507</sup> From these initial cases of 1950s one can distil two key principles, first, the Supreme Court of India, by recognising that a 'taking' can take place by means other than acquisition or requisition, recognised that restrictions on the right to enjoyment of property even if it does not amount to acquisition by the state may still violate right to property,<sup>508</sup> second, it recognised that the test for whether a regulatory measure results in 'deprivation' of property

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<sup>502</sup> AIR 1954 SC 119. It was recognised by the Supreme Court that Article 31(1) and (2) dealt with eminent domain whereas Article 31(5) covered the situations of exercise of police power.

<sup>503</sup> Also see *Saghir Ahmad v State of UP* AIR 1954 SC 728; Sathe (1970), 743; Sathe (1971), 1824.

<sup>504</sup> See Sathe (1970), 743 who has argued that such interpretation would have '*required the state to pay compensation whenever it imposed economic regulation or social control over the use of private property*'. Also see Sathe (1971), 1824.

<sup>505</sup> Id; Also see Singh (2008), 280; Allen (2007) 198.

<sup>506</sup> Id.

<sup>507</sup> Id. Also see *Subodh Gopal Bose v State of WB* AIR 1954 SC 92. For a critical discussion on the reasoning of honourable judges in these cases see Tripathi (1972), 218-24.

<sup>508</sup> In this regard see the arguments of Professor Tripathi who developed the concept of 'constructive eminent domain' and argued that the intention of the constitution makers of India was to recognise that in certain situations a regulatory legislation involving no appropriation but resulting in deprivation of the property may be challenged as 'acquisition' or as 'taking' – Tripathi (1972), 229-30. Also see Jain (2003), 1480; Sathe (1970), 744; Merrillat (1960), 183.

is if the deprivation is ‘substantial’, which ‘seriously impairs’ the right to use and enjoy the property.<sup>509</sup>

These cases prompted the Parliament of India to amend the right to property by bringing the Fourth Amendment Act in 1955.<sup>510</sup> Among other things, the fourth amendment inserted Article 31(2)<sup>511</sup> and (2-A)<sup>512</sup> according to which compensation would only be required if the property is compulsorily acquired (transfer of ownership to state or to any other body owned or controlled by the state) or requisitioned (transfer of right to possession to state) by the state and not by any other means despite the fact that the property may have been deprived.<sup>513</sup> In other words, this amendment ensured that expropriation of property can happen only if there was deprivation-acquisition (by the state) and deprivation alone, even if substantial, was not compensable. This was affirmed by the Supreme Court in *Gullapalli Nageswara Rao v AP SRTC*,<sup>514</sup> a case that came up in 1959 after the fourth amendment act. In this case, the court confirmed that compensation is to be paid only for those ‘takings’ that take place by acquisition or requisition<sup>515</sup> thus, moving away from the pre-fourth amendment cases.<sup>516</sup>

Post 1978 cases also elucidate the significance of compulsory acquisition and requisition as the means to ‘take’ away the property and hence amount to expropriation, which is compensable.<sup>517</sup> *Tara Singh v Union of India*,<sup>518</sup> a case that dealt with ‘coal nationalisation’ in late 1970s, is important in this regard. The issue in this case was whether the Coal

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<sup>509</sup> In this context, it has been argued that the Supreme Court refused to distinguish between exercise of eminent domain and exercise of police power – See Sathe (1971), 1824.

<sup>510</sup> Austin (1999), 101-10; Allen (2007), 198. The first amendment in 1951 had also amended Article 31 by adding Articles 31-A and 31-B with the objective of fully securing the constitutional validity of *zamindari* abolition and other agrarian reform legislation – see Singh (2008), 275.

<sup>511</sup> Article 31(2) as inserted provided, ‘No property shall be compulsorily acquired or requisitioned save for a public purpose and save by authority of a law which provides for compensation for the property so acquired or requisitioned and either fixes the amount of the compensation ...’.

<sup>512</sup> Article 31(2A) inserted through fourth amendment provided, ‘Where a law does not provide for the transfer of the ownership or right to possession of any property to the State or to a corporation owned or controlled by the State, it shall not be deemed to provide for the compulsory acquisition or requisitioning of property, notwithstanding that it deprives any person of his property.’ For a critique of the Fourth amendment see Tripathi (1972), 231-33.

<sup>513</sup> Sathe (1970), 743; Singh (2008), 281.

<sup>514</sup> AIR 1959 SC 308. Also see *MM Pathak v Union of India* AIR 1978 SC 803.

<sup>515</sup> Id.

<sup>516</sup> It is interesting to note that in this case the permit of the private business was terminated and a permit was issued to a state corporation. The Court held that this did not amount to a transfer or acquisition by the state because the regulatory body terminated one permit and issued another permit – thus the act involved two different permits – and hence did not amount to acquisition of the private operator’s property (permit) by the state.

<sup>517</sup> For in-depth discussion on right to property under Constitution of India after the 44th amendment see – Tripathi (1980), 49; Seervai, 1088-89; Basu (1998), 807-08.

<sup>518</sup> AIR 1980 SC 1732.

Nationalisation Act, which terminated the leases and sub-leases (on coal mining) held by different private parties amounted to taking of the property or not. The Supreme Court held that since the Act only provided for the termination of the leases without anything which provided for vesting these interests in the state, this didn't amount to 'acquisition by the state'. The court said "*essential difference between 'acquisition by the State' on the one hand and 'modification or extinguishment of rights' on the other is that in the first case the beneficiary is the State while in the second the beneficiary is not the state.*"<sup>519</sup> Another important aspect of this case is related to right vesting in the state as a direct or immediate flow from the termination of the right (property) held by a private party. The court held that if the vesting is not direct and immediate, in other words, if there is an intervening act between the termination of the property rights of the private party and state acquiring the right, there will be no 'acquisition by the state'.<sup>520</sup> This reasoning was affirmed in *Vij Resins Pvt Ltd v State of Jammu and Kashmir*.<sup>521</sup> The court held that if the state terminates the contract that it had entered into with a private property, which is a property and the same right (which was given in the terminated contract) now being directly vested in the state is 'acquisition of property' and hence compensable.<sup>522</sup> Again, in *Bhuri Nath v State of Jammu and Kashmir*,<sup>523</sup> the Supreme Court held that compensation was not payable for mere deprivation of property or extinction of ownership unless or until the state was the beneficiary.<sup>524</sup> Same was held in *Delhi Cloth and General Mills v Rajasthan SE Board*.<sup>525</sup> In this case, the Supreme Court held that mere extinction of a property right without acquisition by the state is not compensable.<sup>526</sup>

Similarly, in another case, *Jilubhai Nanbhai v State of Gujarat*,<sup>527</sup> on Article 300A, the Supreme Court said '*the deprivation of the property shall be only by authority of law, be it an Act of Parliament or State Legislature, but not by executive fiat or an order. Deprivation of property is by acquisition or requisition or taking possession of for a public purpose*'.<sup>528</sup> The Court further said '*Generally speaking preservation of public health or prevention of damage*

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<sup>519</sup> Id.

<sup>520</sup> Compare this with the deprivation-acquisition conceptualisation offered by Andrew Newcombe for expropriation in IIAs - Newcombe (2005). Newcombe has argued that termination of a lease is also like indirect appropriation. However, Paulsson (2006) has argued that such analogy is erroneous.

<sup>521</sup> AIR 1989 SC 1629.

<sup>522</sup> Id.

<sup>523</sup> AIR 1997 SC 1711.

<sup>524</sup> Id.

<sup>525</sup> AIR 1986 SC 1126.

<sup>526</sup> Id.

<sup>527</sup> AIR 1995 SC 142.

<sup>528</sup> Id.

*to life and property are considered to be public purposes. Yet deprivation of property for any such purpose would not amount to acquisition or possession taken under Article 300A. It would be by exercise of the Police power of the State’.*<sup>529</sup> The court distinguished between exercise of police power and eminent domain and restricted the understanding of expropriation to exercise of ‘eminent domain’.<sup>530</sup> This distinction was recently observed by the Supreme Court of India in *KT Plantation v State of Karnataka*.<sup>531</sup> Dealing exhaustively on Article 300A, the court observed ‘*Eminent domain is distinguishable alike from the police power, by which restriction are imposed on private property in the public interest, e.g., in connection with health, sanitation, zoning regulation, urban planning and so on from the power of taxation, by which the owner of private property is compelled to contribute a portion of it for the public purposes and from the war-power, involving the destruction of private property in the course of military operations. The police power fetters rights of property while eminent domain takes them away’.*<sup>532</sup> The court also held that public purpose is a pre-condition for deprivation of property under Article 300A.<sup>533</sup>

Thus, under Article 300A deprivation of the property will not be compensable if it does not result in acquisition by the state.<sup>534</sup> In other words, a regulatory measure that imposes restrictions on the use of property, even if it results, in substantial deprivation, is not compensable if there is no acquisition or requisition of the property by the state<sup>535</sup> provided the regulatory measure is consistent with the requirement of reasonableness. This shows that understanding of expropriation in Indian law is narrower in comparison to Indian IIAs where expropriation without acquisition and requisition is also recognised.<sup>536</sup>

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<sup>529</sup> Id.

<sup>530</sup> Id. Also see *Anand Singh v State of Uttar Pradesh*, 2008, para 30; Ganguly (2006) 522-23.

<sup>531</sup> *KT Plantation v State of Karnataka* (2011) 9 SCC 1

<sup>532</sup> Id, para 90.

<sup>533</sup> Id, para 143.

<sup>534</sup> In this regard, it is important to mention that the Supreme Court in *KT Plantation v State of Karnataka*, (2011) 9 SCC 1, at one place observed that ‘deprivation’ takes in its fold ‘acquisition’ and ‘requisitioning’ – para 119. This, in other words means, that deprivation is not synonymous to acquisition and requisition; but it is broader to it. It will be interesting to further develop this point to see whether ‘deprived’ in Article 300A can have any other meaning apart from ‘acquisition’ and ‘requisition’.

<sup>535</sup> Jain (2003), 1523.

<sup>536</sup> Indian treaty negotiators were surprised when told about this and said that domestic understanding of the expropriation provision didn’t figure in their negotiations on the expropriation provision. Thus, US has used its IIAs to internationalise its domestic understanding of indirect expropriation, India has been doing the opposite of accepting the US domestic law version of indirect expropriation in its ‘content-indicative’ expropriation provisions.



### 3.3 COMPENSATION

The compensation provision is an integral part of the expropriation provision in all the 73 Indian IIAs. A brief discussion of the compensation provision to show how it has evolved from India's earlier stand on the issue and how it is broader than the compensation requirement in domestic law is relevant before winding up the expropriation chapter.

Article 2(2)(c) of the Charter of Economic Rights and Duties of States (CERDS) provides that each state has the right '*to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means*'. The charter clearly recognises the right to expropriate. Further, the charter states that compensation for expropriation shall be determined on the basis of domestic law. India, in its IIAs, has departed from this provision primarily due to a change in its economic approach towards foreign investment as has been elaborately discussed chapter 2. Most importantly India's stand on the issue of compensation for expropriation has evolved from what is given in Article 2(2)(c) of CERDS as the study of 73 Indian IIAs reveals.

More than 50 of these 73 IIAs contain a provision for fair and equitable compensation. Five of these 55 IIAs contain adequate compensation as the standard of compensation. However, these five IIAs, in addition to the adequate compensation provision, also contain other standards such as compensation should not just be adequate but also effective and should be paid without delay [India-Netherlands – Article 5(1); India-Malaysia – Article 10.7; and India-Finland – Article 5(2)]. Some of the Indian IIAs surveyed also provide for effective and expeditious compensation along with adequate compensation. One IIA [India-Italy – Article 5 (1)] requires that the compensation should be full in addition to expeditious and effective. From the study of the anatomy of the compensation provision in these 73 Indian IIAs, one can safely conclude the following two points. First, the dominant requirement that emerges

through most Indian IIAs surveyed is the requirement to pay fair and equitable compensation. In addition, there are requirements of prompt and expeditious compensation making the compensation provision stringent. Second, Indian IIAs also contain principles on the basis of which the compensation that is to be paid to the investor will be calculated. Out of the 73 Indian IIAs surveyed, more than 60 IIAs state that the value of the compensation should be either the genuine value of the investment or the genuine market value of the investment or the fair market value of the investment. 4 of the IIAs state that the value of compensation should be the real or the actual value of the compensation. Further, all the Indian IIAs require that interest is to be paid to the investor on a fair and equitable rate or at a commercial rate. In other words, Indian IIAs put India under an obligation to pay compensation equivalent to what the foreign investor has been deprived of.

### 3.3.1 Compensation for expropriation in Indian Law

It will be interesting to briefly compare the compensation provision in Indian IIAs with the compensation to be paid under Indian law for ‘takings’. The issue of compensation for property ‘taken’ has been an equally fascinating journey in Indian law ever since the Constitution of India was adopted. The requirement to pay compensation, if the state takes property, was part of the fundamental right to property as mentioned in Article 31(2) above, as originally enacted. The provision mentioned that compensation has to be paid if the state acquired the property. However, the word ‘compensation’ was not qualified by any adjective like ‘just or equivalent’. Notwithstanding this, the Supreme Court in cases before 1955 held that the word ‘compensation’ meant just and equivalent compensation.<sup>537</sup> These rulings perturbed the Central Government because paying full market value compensation for property taken will be too onerous and adversely affect the goal of achieving socio-economic equality.<sup>538</sup> Hence, the fourth amendment was passed in 1955 which made adequacy of compensation non justiciable.<sup>539</sup> Notwithstanding this, the Supreme Court of India continued to exercise the power of judicial review on the issue of compensation although in a different form. In cases after the fourth amendment, the Supreme Court held that although the quantum of compensation was not justiciable, the principles on which compensation was based

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<sup>537</sup> *State of West Bengal v Bella Banerjee* AIR 1954 SC 170; *State of Madras v D Namasivaya Mudaliar* AIR 1965 SC 190. This is despite the fact that the Constitutional Assembly debates made it clear that the legislature was the final authority on adequacy of compensation – Sathe (1970), 743.

<sup>538</sup> Jain (2003), 1483.

<sup>539</sup> *Id*, Sathe (1970), 743.

were.<sup>540</sup> However, there was a difference. Some cases like *Vajravelu v Special Deputy Collector* and *Union of India v Metal Corporation of India* held that the principles on which compensation was based should provide for 'just equivalent' and only if the principles provide for such compensation they will be outside the pale of judicial scrutiny. This was not followed in *State of Gujrat v Shantilal*, where it was held that as long as principles provided for compensation and the compensation was not illusory, the court could not intervene. However, the earlier line was resurrected in *RC Cooper v Union of India* by the Supreme Court.<sup>541</sup>

The approach of the Indian judiciary (Supreme Court) in cases before and after the fourth amendment focusing on 'just equivalent' compensation is same as what is reflected in majority of Indian IIAs. However, it is important to note that the approach of the Indian executive, at that time, was not in favour of paying compensation at the full market rate because paying full compensation would impose onerous burden on state's resources to carry out many socio-economic programmes in a country that was extremely poor and had just gained independence from 200 years of British rule.

The tussle between the Indian judiciary and Indian executive finally saw the enactment of the 25<sup>th</sup> amendment in 1971. This amendment replaced the word 'compensation' with 'amount'. After this amendment, the Supreme Court of India in *Kesvananda Bharti v State of Kerala*<sup>542</sup> held that amount fixed by law can be questioned in court only if the amount is illusory or if the principles given for fixing the amount are irrelevant.<sup>543</sup> Cases under Article 300A of the Constitution have also upheld the principles laid down in cases after the 25<sup>th</sup> amendment that the payment for the expropriated property may not be equal to just equivalent and could be less than that provided the payment is not illusory and the principles for determining compensation must be relevant to arrive at a fair compensation.<sup>544</sup> The Supreme Court in the *KT Plantation* case held that while right to claim compensation is in-built in Article 300A, the state has to justify the compensation granted, 'which may depend on scheme of the

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<sup>540</sup> See *Vajravelu v Special Deputy Collector* AIR 1965 SC 1017; *Union of India v Metal Corporation of India* AIR 1967 SC 637; *State of Gujrat v Shantilal* AIR 1969 SC 634.

<sup>541</sup> On these cases also See Seervai (1967), *Constitutional Law of India*, 359-60; Singh (2008), 284-86; Jain (2003), 1483-488; Sathe (1970); Sathe (1971), 1874-876.

<sup>542</sup> AIR 1973 SC 1461.

<sup>543</sup> Id. Also see *Bhim Singhji v Union of India* AIR 1981 SC 234; *State of TN v L Abu Kavur Bai* (1984) 1 SCC 515; *Assam Sillimanite Ltd v Union of India* AIR 1992 SC 938. For a thorough discussion on the issue of compensation see Singh (1990).

<sup>544</sup> *Jilubahi Nanbhai Khachar v State of Gujrat* AIR 1995 SC 142.

*statute, legislative policy, object and purpose of the legislature and other related factors*'.<sup>545</sup> The court also said that '*measures designed to achieve greater social justice, may call for lesser compensation and such a limitation by itself will not make legislation invalid or unconstitutional or confiscatory*'.<sup>546</sup> Thus, the Indian position is that compensation for the property acquired or requisitioned could be less than full market value provided it is not illusory and the concerned legislation contains the relevant principles to determine compensation.<sup>547</sup> This position is different from the compensation provision that India has undertaken in its IIAs which require market value of investment along with interest to be paid to the foreign investor.

## ***SUMMARY***

The current formulation of the expropriation provision in the 'limited-content' expropriation provisions requires sole focus on effect of the measure, which should be same as effect that would result had the investment been directly expropriated. Thus, the indirect textual reference is to the 'substantial deprivation' test. However, this formulation is silent on the issue of conceptual severance, thus opening up the possibility of a broad interpretation of the 'substantial deprivation' test where the bundle of investor's property rights could be severed to determine indirect expropriation. Higher degree of severance could result in more regulatory measures being held expropriatory.

While the use of 'purpose-test' promises to serve India's regulatory power, the present formulation of the 'limited-content' type expropriation formulation in 57 IIAs does not support this test. These tests are a response to the critique of IIAs failing to balance investment protection with host country's regulatory power. Though one needs to strike a balance between regulation and investment protection, this cannot be done by misinterpreting the 'limited-content' type expropriation provisions and hence doing violence to their formulation and language sidetracking rules of treaty interpretation to achieve a particular objective. Both the versions of the 'purpose-test' are a result of a faulty treaty interpretation methodology. Furthermore, even this interpretation is no assurance that India's regulatory

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<sup>545</sup> *K T Plantation v State of Karnataka*, para 143.

<sup>546</sup> *Id.*, para 121.

<sup>547</sup> In this regard also see the debates on issues related to compensation as part of the Land Acquisition Act.

power will be safeguarded if the proportionality test is followed because of the inherent value-laden discretion that such a test bestows on *ad hoc* arbitrators. The police power test will serve India's regulatory power better because of the wide amplitude of public purpose that can pass muster under it although this test runs the risk of failing to strike balance between regulation and investment protection.

The formulation of the 'content-indicative' expropriation provisions provides many factors to determine indirect expropriation. The intent clearly is to balance investment protection with India's ability to exercise regulatory power. It also provides safe haven for bonafide regulatory measures for public purpose notwithstanding the effect on foreign investment. However, some of the formulations swing the pendulum too much in favour of India's regulatory power and thus do not strike balance between investment protection and India's regulatory power. Further, whether this formulation will be able to preserve India's regulatory power will depend on the outcome of the proportionality test. Proportionality test vests much discretion in the hands of the *ad-hoc* arbitration tribunals. Hence, one cannot rule out situations where even a measure adopted for important public welfare objectives could be held expropriatory if the tribunal is of the view that although the benefits of the public purpose are great; the adverse costs imposed by the impugned measure are greater. Moreover, the formulation of the 'content-indicative' expropriation provisions is not consistent with the NPM provisions in the same IIAs. Further, some of these IIAs along with the proportionality test also contain the police power test. This is problematic for two reasons, first, it swings the pendulum too much in favour of India's regulatory power, and second, it is irreconcilable with the proportionality test. Also, India's provisions on expropriation and compensation for expropriation are much broader in comparison to the understanding of these terms in Indian domestic law. India has been following the formulation of expropriation provision and compensation for expropriation in its IIAs without giving much thought about the relationship of these provisions with the understanding of these terms in India's domestic law.

## CHAPTER 4

### FAIR AND EQUITABLE TREATMENT

Fair and equitable treatment (FET) has emerged as the most important standard of treatment in IIAs<sup>548</sup> and has attracted considerable scholarly attention.<sup>549</sup> FET provision occurs in almost all IIAs;<sup>550</sup> often without much guidance about its meaning and content.<sup>551</sup> The vague and expandable nature of the FET provision has made it extremely popular amongst foreign investors to challenge host state's regulatory measures.<sup>552</sup> In fact, it has become a catch-all provision capable of sanctioning many legislative, regulatory and administrative actions of the host state due to a largely unresolved scope and content of the FET provision.<sup>553</sup> Many eminent scholars corroborate this view. For example, according to Dolzer and Schreuer FET is '*the most frequently invoked standard in investment disputes*';<sup>554</sup> and '*a majority of successful claims pursued in international arbitration are based on a violation of the FET standard*'.<sup>555</sup> Vandevelde, writing on the FET provision, states '*because the language by its terms can apply to virtually any instance of host-state conduct, it is potentially a basis for recovery in any situation*'.<sup>556</sup> Sornarajah has described the FET provision as '*nebulous*'.<sup>557</sup> FET provision has attracted considerable attention in investor state disputes in view of the difficulty in finding an expropriation.<sup>558</sup> Hence, it should not come as a surprise that a wide array of host country's regulatory measures related to privatisation,<sup>559</sup> monetary

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<sup>548</sup> Newcombe and Paradell (2009), 254. Salacuse describes FET as the *grundnorm* or basic norm of the investment treaty system – See Salacuse (2010), 219.

<sup>549</sup> Mann (1981), 241; Vasciannie (1999), 99; UNCTAD (1999); Thomas (2002), 21; Yannaca-Small (2005); Dolzer (2005), 87; Schreuer (2005), 357; Choudhury (2005), 297; Schill (2006); Fietta (2006), 375; Westcott (2007), 409; Mayeda (2007), 273; McLachlan *et al* (2007); Dolzer and Schreuer (2008); Paradell (2007), 117; Tudor (2008); Newcombe and Paradell (2009); Salacuse (2010); Vandevelde (2010); 43; Klager (2011).

<sup>550</sup> Newcombe and Paradell (2009), 254.

<sup>551</sup> Scholars have described FET as wide, tenuous and imprecise – See Sornarajah (2004), 332; Lowe (2002), 9; Schreuer (2005), 364; UNCTAD (2007), 41; Salacuse (2010), 221; Vandevelde (2010), 69.

<sup>552</sup> Salacuse (2010), 218.

<sup>553</sup> Picherack (2008), 255; Subedi (2008), 172-173. Also see Mayeda (2007), 291 and Van Harten (2007), 89.

<sup>554</sup> Dolzer and Schreuer (2008), 119.

<sup>555</sup> *Id.*

<sup>556</sup> Vandevelde (2010), 203.

<sup>557</sup> Sornarajah (2010), 349

<sup>558</sup> Subdei (2008), 175. Dlozer and Schreuer (2008) also make the point that tribunals have preferred to find a violation of FET over finding an expropriation. Also see Schreuer (2009), 2-4. Also see *PSEG Global Inc et al v Turkey*, ICSID Case No ARB/02/5, para 238.

<sup>559</sup> *Eureko v Poland*, ICSID Case No ARB/01/11, 19 August 2005.

sovereignty;<sup>560</sup> and environment<sup>561</sup> have been challenged by foreign investors as violations of the FET provision with varying degrees of success. These developments have given rise to a wide debate on whether FET provisions restrict host country's regulatory power.<sup>562</sup>

In light of this overall debate between FET and regulation, this chapter will study the FET provision in 73 Indian IIAs in order to answer the central question of the thesis – will the present formulation of the FET provisions in Indian IIAs lead to interpretations giving precedence to investment protection over India's regulatory power? Section 4.1 of the chapter will discuss the anatomy of the FET provision in 73 Indian IIAs carefully noting the textual difference in the provision in different Indian IIAs. Since, an important issue surrounding the FET provision in IIAs relates to the nature of the FET standard – whether it is same as the international customary law of minimum standard of treatment (MST) of aliens or is it an autonomous treaty standard,<sup>563</sup> section 4.2 will discuss India's riveting stand on MST of aliens under customary international law (CIL). Section 4.3 will focus on determining the content of the FET standard in these 73 Indian IIAs. The content will be determined by relying on treaty interpretation tools and the approaches adopted by different arbitral tribunals. Drawing from the previous discussion, this section will also deal with the issue of whether India is under an obligation to provide fair and equitable treatment as part of CIL.

#### **4.1 ANATOMY OF THE FET PROVISION IN INDIAN IIAs**

A study of 73 Indian IIAs reveals that as many as 71 Indian IIAs contain the FET provision. The two Indian IIAs that do not contain the FET provision are with Turkey and Singapore. India-Turkey IIA was signed in 1998 but came into force in 2007 and India-Singapore IIA came into force in 2005.

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<sup>560</sup> *CMS Gas Transmission Co v Argentina*, ICISD Case No ARB/01/8; *CMS Gas Transmission Company v Argentina*, ICSID Case No ARB/01/8 (Annulment Proceedings); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3; *Enron Creditors Recovery Corp v Argentina* ICSID Case No ARB/01/3 (Annulment Proceeding); *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16; *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16 (Annulment Proceedings); *LG&E Energy Corporation v Argentina*, ICISD Case No ARB/02/1; *Continental Casualty Company v Argentina*, ICSID Case No ARB/03/9.

<sup>561</sup> *Methanex v United States* (Final Award), UNCITRAL-NAFTA, 3 August 2005.

<sup>562</sup> Schniederman (2008), 95-105; Mayeda (2007), 291; Kaushal (2009), 526; Miles (2010), 42-44; Klager (2011), 251; Picherack (2008), 255.

<sup>563</sup> OECD (2004); UNCTAD (1999), 10-13; Schreuer (2005), 359-364.

These 71 Indian IIAs, which contain the FET provision, can be divided into three types. First, ‘model-IIA’; second, ‘modified-model IIA’; and third, ‘content-indicative IIA’. The ‘model-IIA’ type means those IIAs where the FET provision is same as the FET provision in the model Indian IIA. ‘Modified-model IIA’ type means those FET provisions that are slightly different from the one given in the ‘model-IIA’ type. ‘Content-indicative IIA’ type means those FET provisions that provide some indication of its possible content. Let us understand each of these and their trends.

**Table 4.1 – Indian IIAs containing FET standard**

<b>FET provision</b>	<b>Number of IIAs</b>
Present	71
Absent	2 – India-Singapore and India-Turkey. India-Turkey IIA mentions about FET only in the preamble.

*Source – Author’s study of 73 Indian IIAs*

#### 4.1.1 ‘Model-IIA’ type FET provisions

Article 3 (2) of the Indian model IIA gives the FET provision - ‘*Investments and returns of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party*’. The meaning of FET is not given in the model IIA. It only states that foreign investment has to be accorded FET ‘at all times’. The FET provision is part of Article 3, which is titled as ‘Promotion and Protection of Investment’. Paragraph 1 of Article 3 states – ‘*Each Contracting Party shall encourage and create favourable conditions for investors of the other Contracting Party to make investments in its territory, and admit such investments in accordance with its laws and policy*’. Thus, the sub-article of the provision containing FET emphasises on encouraging and creating favourable conditions for foreign investment.

The FET provision in the model IIA (although part of the title ‘promotion and protection of investments’) exists as a standalone provision and is not combined with protection and



security of investments or with national treatment and most favoured nation clause. The same formulation of FET exists in as many as 36 Indian IIAs (including the model-IIA) out of the 71 that contain the FET provision, and thus, the FET provision in these 36 Indian IIAs is called the ‘model-IIA’ type. There is no one specific trend about this kind of FET formulation. Such formulation occurs in India’s IIAs with both developing and developed countries like Australia, Israel, Poland, Sri Lanka, Egypt, Vietnam, Romania, China, Indonesia, Mozambique, Senegal, Latvia and others. Further, there is no one trend in terms of time period. India’s earliest IIAs with Israel entered in 1996 and India’s later IIAs signed with countries like China, Latvia and Mozambique in 2006, 2010 and 2009 respectively contain the same model-IIA FET provision.

#### 4.1.2 ‘Modified-model IIA’ type

‘Modified-model IIA’ type represents those FET formulations, which are not very different from the formulation in the model Indian IIA. The minor features that distinguishes ‘model-IIA’ type FET formulation from ‘modified-model IIA’ type formulation is that in the latter, the FET provision does not exist in a standalone form but in combination with either full protection and security, or in combination with national treatment and MFN (India-Denmark), or in combination with the requirement to promote investments. In ‘modified-model IIA’, FET formulations in IIAs with the following countries exists in combination with full protection and security - UK, Germany, Italy, Czech Republic, Spain, Switzerland, Uzbekistan, Morocco, Sweden, Thailand, Argentina, Finland, Hungary, Trinidad and Tobago, Hellenic Republic, Iceland, Mexico, Brunei, Syria, Yugoslavia, Korea. For example, Article 3 (2) of the India-UK IIA provides – *‘investments and investors of each contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other contracting party.’*

**Table 4.2 – Anatomy of the FET provisions in 71 Indian IIAs**

<b>Type of FET Formulation</b>	<b>Number of Indian IIAs having this type of FET formulation</b>
‘Model-IIA’	37

‘Modified-Model IIA’	29
‘Content-Indicative’	5

*Source – Author’s study of 71 Indian IIAs that contain the FET provision*

In some IIAs [with Italy - Article 3 (2); Finland - Article 3(3); and Trinidad and Tobago – Article 3 (2)] along with full protection and security, FET exists in combination with another provision according to which the host country is barred from adopting unreasonable and discriminatory measures against foreign investment. Similarly, India-Finland IIA (entered in 2002), which provides FET in Article 3(3), along with full protection and security, also imposes an obligation on India not to impair management, maintenance, use, enjoyment or disposal of investment by adopting unreasonable or discriminatory measures. Similar sort of formulation also exists in India-Mauritius IIA. Article 4(1) provides that *‘Investments and returns of investors of either Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal or investments in its territory by investors of the other Contracting Party’*.

Out of 29 ‘modified-model IIA’ FET provisions, in 25 of them the FET obligation is part of the provision titled ‘promotion and protection of investment’. In four ‘modified-model IIA’ FET formulations, the FET obligation is contained in provisions having titles other than ‘promotion and protection of investment’ such as India-Mauritius IIA where the FET provision is part of an Article titled ‘treatment of investments’.

The important unifying factor in the two types of IIAs is that they do not provide the normative content of the FET provision. In other words, the FET provision in ‘modified-model IIA’ also remains undefined barring the IIAs with Denmark – Article 3(2) and Kuwait – Article 5 (1), which mention that FET standard cannot be below national treatment and MFN and hence providing the floor.

It is difficult to draw any specific trend in the formulation of the FET provision when both ‘model IIA’ and modified-model IIA’ are taken together. There are instances of agreeing to

both ‘model-IIA’ and ‘modified-model IIA’ FET formulations almost at the same time. The FET formulation in India-Germany IIA and India-Italy IIA both entered in 1995 is of ‘modified-model IIA’ type whereas the FET formulation in India-Poland IIA entered in 1996 is ‘model-IIA’ type.

The only interesting trend to note is that after the Enron debacle,<sup>564</sup> India’s IIA with Singapore, which was negotiated almost at the same time when the Enron debate was going on, does not contain the FET provision. However, lack of FET is not a feature of any of the other IIAs signed by India at that time. Thus, except for India-Singapore, all Indian IIAs of that time such as India-China IIA contain a FET provision. Similarly, India-Malaysia and India-Japan IIAs, though have investment provisions similar to those given in India-Singapore IIA, also provide for a FET provision. The FET formulation in these IIAs will be discussed in detail in the ‘content-indicative’ IIA part of the chapter.

#### 4.1.3 ‘Content-Indicative IIA’

Out of the 71 IIAs that contain the FET provision, five IIAs provide some content or direction regarding the meaning of the FET provision and hence are referred as ‘content-indicative’ IIAs. These IIAs are with France, Mexico, Korea, Malaysia and Japan. In these IIAs reference is made to the minimum standard of treatment. In India-France IIA, the reference is not so clear because Article 4(2) says that FET treatment is to be extended in accordance with internationally established principles to investments.

India’s IIAs with Mexico,<sup>565</sup> Korea (Article 10.4.1), Malaysia (Article 10.5) and Japan (Article 87.1) clearly provide that FET standard shall not require treatment in addition to the MST of aliens under CIL. For example, Article 10.4 (1) of the India-Korea IIA states – ‘*Each Party shall accord to an investment of an investor of the other Party in its territory “fair and equitable treatment” and “full protection and security.” The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or*

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<sup>564</sup> *Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Maharashtra Power Development Cooperation Limited*, International Court of Arbitration of the ICC, Case No. 12913/MS.

<sup>565</sup> In response to the ruling in *Tecmed SA v United Mexican States*, ICSID Case No ARB (AF)/00/2, 29 May 2003 involving Spain-Mexico IIA, where it was held that the FET provision is autonomous, in 2006 Spain and Mexico renegotiated their existing IIA to change the FET formulation by linking it with MST of aliens under customary international law. Similarly, Mexico has followed this type of FET formulation in its IIA with China in 2008; and with Singapore in 2009.

*beyond that which is required by the customary international law minimum standard of treatment of aliens'. Article 87 of the India-Japan IIA states – 'Each Party shall accord to investments of investors of the other Party treatment in accordance with international law, including fair and equitable treatment and full protection and security'. It further provides 'This paragraph prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of the other Party. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this paragraph'. A similar kind of provision linking FET with MST of aliens under CIL exists in Article 10.5 of the India-Malaysia IIA.*

#### **4.2 INDIA'S STAND ON THE MST OF ALIENS UNDER CIL**

India's stand on MST of aliens under CIL has evolved over the years and can be linked to India's economic policy and thinking - discussed in chapter 2. Dependence on foreign investment to meet India's investment needs in early decades after India's independence was kept quite low.<sup>566</sup> As it has been elaborately discussed in chapter 2, India's economic policy and thinking in the 1950s and till about 1980s was based on import substitution, self-reliance and promoting indigenous industries. The period of 1950s and 1960s witnessed India and other countries of Asia and Africa, who had gained independence from their European colonial rulers, asserting themselves to build a new international legal order emphasising their sovereign status.<sup>567</sup> A key development in 1950s was the setting up of Asian Legal Consultative Committee (ALCC) on 15 November 1956 with India along with six other Asian countries being the founding members.<sup>568</sup> In 1958, African countries also become members of this group and later this group came to be known as Asian-African Legal Consultative Organization (AALCO) with its primary objective being to act as an advisory body to member states on international law matters. At the fourth session of this committee,

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<sup>566</sup> Chandra *et al* (2008), 452.

<sup>567</sup> Work of Indian scholars of that time reflect this - Anand (1961), 383; Guha Roy (1961), 863; Anand (1966), 55. Also see Pacht (1962), 76.

<sup>568</sup> For more on ALCC (now called AALCO) see - <http://www.aalco.int/>

member countries adopted a document called '*Principles Concerning Admission and Treatment of Aliens*'.<sup>569</sup> Article 11 of this document states '*Subject to local laws, regulations, and orders and subject also to the condition, imposed for his admission into the State, an alien shall have the right to acquire, hold and dispose of property*'. Further Article 12 (1) states '*The State shall, however, have the right to acquire, expropriate or nationalise the property of an alien. Compensation shall be paid for such acquisition, expropriation or nationalisation in accordance with local laws, regulations and orders*'. This language clearly signaled that while the alien will be lawfully treated without arbitrariness, this treatment will be as per the national laws of the host country and thus, will be in accordance with the principle of national treatment. In other words, this stand of India and other Asian and African countries rejected a minimum standard of treatment of aliens independent of national treatment.

In 1957, the Indian member of the International Law Commission (ILC), Radhabinod Pal, mounted a very strong challenge to the draft report of the Special *Rapporteur* Garcia Amador who linked the issue of content of the international minimum standard with fundamental human rights concept.<sup>570</sup> Pal challenged the European hegemony of international law arguing that the geography of international law has changed in the post-war period with the rise of a large number of newly independent nation states in Asia like India and hence these countries should be involved in developing international law.<sup>571</sup> Thus, Pal challenged the content of the proposed international minimum standard in economic relations and argued that it was nothing but an attempt to thrust on the rest of the world the European notion of the international minimum standard without understanding the social and economic difficulties of countries like India.<sup>572</sup>

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<sup>569</sup> *Principles Concerning Admission and Treatment of Aliens*, Asian Legal Consultative Committee (ALCC) available at <http://www.aalco.int/PRINCIPLES%20CONCERNING%20ADMISSION%20AND%20TREATMENT%20OF%20ALIENS.pdf>

<sup>570</sup> Garcia Amador (1957), 112-116.

<sup>571</sup> Pal (1957), 158. Garcia Amador's position has also been criticised by Sir Ian Brownlie – See Brownlie (2008), 527.

<sup>572</sup> Pal (1957), 158.

In 1960s, the adoption of the UN General Assembly Resolution declaring permanent sovereignty over natural wealth and resources<sup>573</sup> also indicated the rejection of the law relating to responsibility of states espoused by developed countries.<sup>574</sup> As it has been elaborately discussed in chapter 2, this was followed by India and other developing countries by attempting to develop a New International Economic Order (NIEO).<sup>575</sup> As a part of this process the United Nations General Assembly, on 12 December 1974, adopted the Charter of Economic Rights and Duties of States (CERDS). Article 2(2) (a) of the Charter states that each state has the right *‘to regulate and exercise authority over foreign investment within its national jurisdiction and in accordance with its laws and regulations and in conformity with its national objectives and priorities. No state shall be compelled to grant preferential treatment to foreign investments’*. This provision was opposed by 10 developed countries (mainly capital exporting countries) who wanted host countries to treat foreign investments as per what they thought to be the international obligations.<sup>576</sup> However, India and other developing countries maintained that all investors, foreign or national, should function as per the national laws of the country and there should not be any preferential treatment for foreign investors.<sup>577</sup> In other words, India, in 1974, based on its economic ideology rooted in import substitution and self-reliance, argued for national treatment as the minimum international standard and not for an autonomous minimum standard for foreign investments different from the treatment given to Indian investors.

Similarly, Article 2(2) (b) of CERDS on transnational corporations (TNCs) states that each state has the right to regulate and supervise the activities of the TNCs within its national jurisdiction in accordance with its laws, regulations, economic and social policies. An Indian scholar commenting on this in 1977 has written that *‘developed countries recognized that a state may control their entry and activities within its territory, they wanted the corporations to retain the protection of the international standards applicable to foreigners’*,<sup>578</sup> which was not acceptable to India and other developing countries. An Indian official writing on NIEO in

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<sup>573</sup> **General Assembly resolution 1803 (XVII) of 14 December 1962, ‘Permanent sovereignty over natural resources’ available at <http://www2.ohchr.org/english/law/resources.htm>**

<sup>574</sup> See the arguments of late Professor R P Anand, one of India’s prominent international law scholars – Anand (1966), 69.

<sup>575</sup> See the Introductory chapter for more details on NIEO.

<sup>576</sup> Rao (1975), 360.

<sup>577</sup> *Id*, 360.

<sup>578</sup> Agarwala (1977), 271.

1978 mentioned that developing countries wanted to create a new international economic order based on equality which would enable them to subject TNCs to national discipline.<sup>579</sup>

The biggest opposition to accepting an international minimum standard different from national treatment was reflected in Article 2(2) (c) of CERDS on the question of compensation for expropriation. As discussed in chapter 3 (on expropriation), the question of compensation for expropriation was to be decided as per the national laws. On the demand of developed countries that the question of compensation should be decided as per the principles of international law, India and other developing countries denied the existence of any such principle in international law.<sup>580</sup>

Further, developed countries wanted to include another paragraph to Article 2 to provide that measures taken in exercise of rights provided in the Article ‘shall fulfill in good faith their international obligations’.<sup>581</sup> This was an attempt by developed countries to make sure that countries abide both by treaty law and by what they considered the CIL to be. However, India and other developing countries argued that they will accept this only if the above provision was qualified by ‘freely undertaken’.<sup>582</sup> This was a clear indication to reject the version of CIL advocated by developed countries because of the belief that countries like India, which gained independence only in 1947, didn’t take part in the development of this customary law and hence were not bound by it.

However, India’s position started to change in 1990s when it made a paradigm shift in its economic policy due to a severe balance of payment crisis in 1991 as discussed elaborately in chapter 2. This change in economic policy and thinking also led to a change in India’s understanding on international law related to foreign investments. With the desire to welcome foreign investment, India started entering into IIAs with broad investment protection provisions including the obligation to treat foreign investors fairly and equitably. This showed India’s change of heart from opposing the international minimum standard in the post-colonisation period to adopting a more pragmatic approach in the 1990s to negotiating investment protection agreements due to the changed economic scenario, as pointed out by a

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<sup>579</sup> Shukla (1978), 291.

<sup>580</sup> Rao (1975), 361; Agarwala (1977), 267. Also see Sornarajah (2010), 123 according to whom Article 2 (2) (c) is in effect a restatement of the Calvo Doctrine. For discussion on how contentious this article was - see White (1975), 546.

<sup>581</sup> Rao (1975), 361.

<sup>582</sup> Id, 362.

prominent Indian official, who headed the legal and treaties division in India's foreign ministry.<sup>583</sup> Although there has been a change in India's stand on MST of aliens under CIL like accepting the prompt and effective standard of compensation for expropriation in its IIAs, as discussed in chapter 3; it is doubtful whether India has fully embraced other issues like accepting to treat foreign investment as per some international standard different than the national standard. This issue is further discussed in Section 4.3.3.

### ***4.3 CONTENT OF THE FET STANDARD***

Determining the content of the FET standard is important in order to find out its implications on exercise of regulatory power. The content of the FET provision in Indian IIAs will be determined first by focussing on the 'model-IIA' and 'modified-model IIA' FET formulations. Both these types of formulations are discussed jointly because of the similarity in their formulations. This will be followed by focussing on the 'content-indicative' IIA FET formulation. As it will be discussed below, based on the treaty language, two different interpretative routes can be followed to interpret the FET provision in Indian IIAs. First, the 'autonomous approach' which interprets the FET provision independent of the MST of aliens under CIL; second, the equating approach that equates the FET provision with the MST of aliens under CIL. In other words, content of the FET provision will be determined by determining the content of the MST of aliens under CIL. The chapter will also discuss a third approach, called the 'convergence approach'. According to this approach the FET provision in IIAs has converged with CIL and has become part of CIL.<sup>584</sup>

#### ***4.3.1 'Model-IIA' and 'Modified-model IIA' FET formulations***

The interpretation of the 'model-IIA' type and 'modified-model IIA' type FET formulation will examine both the interpretative routes by focussing on the language of the treaty.

##### ***Autonomous Approach***

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<sup>583</sup> Rao (2000), 626.

<sup>584</sup> Haeri (2010), 43.



As mentioned above, an autonomous approach to interpreting the FET provision in an IIA implies finding the content of the FET provision independent of any MST of aliens under CIL. In other words, the content of the FET provision will not hinge on international minimum standard and may be broader than the narrower minimum standard.<sup>585</sup>

The ‘model IIA’ and ‘modified-model IIA’ FET formulations do not explicitly link to MST of aliens under CIL. There is also no reference or mention of FET treatment being no less than that required by international law.<sup>586</sup> It only imposes an obligation on India to treat foreign investors fairly and equitably without providing any guidance on whether such treatment is to be determined by taking cognizance of the MST of aliens under CIL. Hence, it can be argued that the absence of the treaty making an explicit link between the FET provision and MST of aliens under CIL clearly indicates that the FET provision in these 66 IIAs supports an autonomous interpretation of the FET provision independent of any MST of aliens under CIL. In other words, if India would have intended to limit FET to MST of aliens under CIL it would have specifically provided for that in the treaty.<sup>587</sup>

There is lot of academic literature that supports the argument that the FET provision should be considered an autonomous standard in those IIAs that do not link the FET provision with the MST of aliens under CIL.<sup>588</sup> Many arbitral tribunals have also adopted this approach. The *Saluka* tribunal, for example, had to interpret Article 3(1) of the Netherlands-Czech and Slovak Republic IIA, which provides – ‘*Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management,*

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<sup>585</sup> See *Cargill, Incorporated v United Mexican States*, ICSID Case No ARB (AF)/05/2, para 285; *PSEG v Turkey*, ICSID Case No ARB/02/5, para 239; *Enron Corp Ltd v Argentina*, ICSID Case No ARB/01/3, para 258.

<sup>586</sup> See Article 2(2) of Argentina-US BIT, which provides for FET, and also states that investments shall ‘in no case be accorded treatment less than required by international law’. In fact, recently, the tribunal in *AWG Group v Argentina*, UNCITRAL, 30 July 2010 deciding on the FET provision in Argentina-France IIA, which referred to the ‘principles of international law’ and not to the minimum standard under customary international law held that reference to international law is not same as reference to MST – para 184. In this regard see the arguments of some authors who argue that it is inconsequential whether an explicit mention of ‘international law’ is made or not – Knoll-Tudor (2009), 317.

<sup>587</sup> Also see Schreuer (2005); *AWG v Argentina*, para 184.

<sup>588</sup> See Mann (1981), 1244; Gudgeon (1986), 125; McLachlan *et al* (2007), 226-247; Dolzer and Stevens (1995), 60; Vasciannie (1999), 104-105; Schreuer (2005), 364; Dolzer and Schreuer (2008), 124; Yannaca-Small (2008), 114; Vandevlede (2010), 193. Many countries have made the argument before the arbitral tribunals that FET reflects the international minimum standard. For example Argentina in *Azurix v Argentina*, ICSID Case No ARB/01/12, 23 June 2006, para 332 and *CMS Gas Transmission v Argentina*, ICSID Case No ARB/01/8, 12 May 2005, para 271; Czech Republic in *Saluka Investment BV v Czech Republic*, UNCITRAL, 17 March 2006, para 289; Pakistan in *Bayindir Insaat Turizm VeSanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29, para 587.

*maintenance, use, enjoyment or disposal thereof by those investors*'. This FET formulation is quite similar to the FET formulation of the 'modified-model IIA' type. The *Saluka* tribunal held that omission of any reference to customary international standard in the FET formulation points to the autonomous character of the FET standard.<sup>589</sup> More recently, the arbitral tribunal in *Lemire v Ukraine*<sup>590</sup> while interpreting a FET provision which stated '*Investments shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law*' held that the FET standard in the IIA is an autonomous treaty standard.<sup>591</sup> Adoption of the autonomous approach to determine the content of the FET provision makes the issue of whether the FET provision in Indian IIAs reflects the MST of aliens under CIL non-consequential.<sup>592</sup> However, some tribunals adopting the autonomous approach have also passed observations on whether FET reflects MST of aliens under CIL - this is discussed in Section 4.3.3.

The fact that FET provision in these 66 Indian IIAs is autonomous from the MST of aliens under CIL does not help much in determining the content of the FET standard. Hence, the discussion below will focus on using other treaty interpretation tools given in Articles 31 and 32 of the VCLT to determine the content of the FET standard.<sup>593</sup> As it has been discussed elsewhere, Article 31 (1) requires interpreting the treaty by giving ordinary meaning to the terms used. According to the Oxford dictionary, the word 'fair' means 'treating people

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<sup>589</sup> *Saluka* tribunal, para 294. The tribunal in *MTD Equity Sdn Bhd & MTD Chile SA v Chile*, ICSID Case No ARB/01/7, 25 May 2004 also stated that since there was no reference to customary international law in relation to the FET provision in the BIT, it was obliged to apply the standard autonomously – paras 111-112. Also see *Tecmed v Mexico*, para 155; *PSEG v Turkey*, para 239; *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16, 28 September 2007, para 302; *Enron v Argentina*, para 258; *AWG v Argentina*, para 186. The tribunal in *National Grid v Argentina* said that since there is no reference to MST of aliens under international law therefore the tribunal will proceed to examine the ordinary meaning of the words 'fair' and 'equitable' – para 167. Furthermore, in *Azurix v Argentina*, where Article 2.2 (a) of the IIA, containing the FET provision, also states that treatment shall in no case be less than required by international law, the tribunal held that this formulation allows to interpret FET as a higher standard of investment protection – para 361.

<sup>590</sup> *J C Lemire v Ukraine*, ICSID Case No ARB/06/18.

<sup>591</sup> *Id.*, para 284. The tribunal said that the reference to international law in the IIA is to set the floor and not the ceiling – para 253.

<sup>592</sup> See *Occidental*, *CMS* and *Enron* tribunals. Also see generally Newcome and Paradell (2009), 273; *BG Group Plc v Argentina*, UNCITRAL (Final Award), 24 December 2007, paras 289-310;

<sup>593</sup> Newcombe and Paradell (2009), 263; Tudor (2008), 145. Also see UNCTAD (2007), 41 which provides that the interpretation of the FET provision will vary significantly based on the language of the text. See *Enron* tribunal, para 259 where the tribunal states that it is bound to interpret the provision on FET as per Article 31 of the VCLT. In this regard arguments have also been made that arbitral tribunals have not given different interpretation or meaning to the FET standard based on the context in which the standard appears – Vandevelde (2010), 203. Also see Choudhary (2005) pointing to textual differences in treaty provisions as the reason for lack of a universally accepted definition of the FET standard and hence pointing to the significance of treaty interpretation rules to find out the meaning of the FET provision.

equally without favouritism and discrimination’ and ‘just or appropriate in circumstances’. The word ‘equitable’ means ‘impartial or reasonable’. The word ‘treatment’ is defined in the English Oxford dictionary as ‘*the manner in which someone behaves or deals with someone or something*’.<sup>594</sup> This definition essentially means focussing on the conduct of the person concerned. Thus, FET is a standard of host state’s conduct *vis-à-vis* foreign investment.<sup>595</sup> FET requires India’s conduct towards foreign investment to be just and impartial or reasonable. However, finding the ordinary meaning does not help much in finding the meaning of FET because the ordinary meaning of ‘fair’ and ‘equitable’ throws up words, which are equally vague and broad.<sup>596</sup>

The next important step is to find the ‘context’ in which these words appear. In all ‘model-IIA’ FET formulations and in majority of ‘modified-model IIA’ FET formulations, the FET provision occurs under the heading of ‘promotion and protection of investments’. This indicates that determination of whether host state’s conduct towards foreign investment is fair and equitable should be guided by values such as promotion and protection of investment.<sup>597</sup> Furthermore, the immediate context of the FET provision is that the obligation to treat foreign investment fairly and equitably exists along with a provision according to which the host country shall encourage and create favourable conditions for foreign investors. The presence of this provision under the same heading of ‘promotion and protection of investment’ and as the ‘immediate context’ for the FET obligation also points towards values like promotion and creating favourable conditions for foreign investments as guides to determining whether India’s conduct as a host nation towards foreign investment is fair and equitable or not.

In ‘modified-model IIA’ FET formulations, the immediate context of FET is that it exists in combination with other investment protection clauses like ‘full protection and security’ and restrict to impose or adopt ‘unreasonable and discriminatory measures’. The presence of

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<sup>594</sup> See <http://oxforddictionaries.com/definition/treatment?region=us>

<sup>595</sup> Also see the separate opinion of Arbitrator Pedro Nikken in *AWG v Argentina* who describes FET as a standard of conduct – see para 19 of his dissenting judgment. Generally on dissenting opinions by party-appointed arbitrators in ITA see – Berg (2011), 821.

<sup>596</sup> *Saluka*, para 297. Also see *MTD*, para 113.

<sup>597</sup> See *Siemens AG v Argentina*, ICSID Case No ARB/02/8, 6 February 2007, para 290; *Azurix v Argentina*, paras 359-360 for adopting the same interpretative methodology. Also see *Saluka* tribunal which used the same treaty interpretative methodology and came to the conclusion that FET should at least be understood to be treatment which is not proactively encouraging foreign investment does not at least deter foreign investment by creating disincentives – para 301.

these clauses point towards interpreting FET with investment protection as the key guiding principle.<sup>598</sup> It is also interesting to note that while almost all Indian IIAs recognise limited exceptions to national treatment and most favoured nation treatment such as not extending MFN to foreign investors due to an existing or a future customs area or not extending national treatment in matters related to taxation; no such specific exception exists for the FET provision barring the general exception that exists in the form of a Non Precluded Measure (NPM) clause (see the discussion chapter 6). This also indicates the importance that India has attached to the obligation of providing FET to foreign investment.<sup>599</sup>

As discussed in chapter 2, the overall object and purpose of the majority of Indian IIAs is investment protection and promotion. Thus, the context, and the object and purpose of the ‘model-IIA’ and ‘modified-model IIA’ FET formulations suggests that the interpretation of FET in these Indian IIAs should be such that promotes the goal of investment protection and promotion. Such broad and unqualified ‘model-IIA’ and ‘modified-model IIA’ FET formulation coupled with the discussion on context, and object and purpose, supports the adoption of an expansive interpretation.<sup>600</sup> An autonomous and expansive interpretation of the FET provision implies that a large range of host state’s regulatory conduct can be brought under the ambit of the FET provision.<sup>601</sup> It gives much scope for arbitral discretion to read into the FET provision what the arbitrators think fit.<sup>602</sup> A recent example of this discretion is the reasoning of the ITA tribunal in *El Paso v Argentina*.<sup>603</sup> The tribunal introduced an unknown concept of ‘*creeping violation of the FET provision*’.<sup>604</sup> According to this, even if individual regulatory measures do not violate the FET provision, a cumulative effect of all such regulatory measures may violate the FET provision.<sup>605</sup> The discussion below will focus

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<sup>598</sup> *MTD v Chile*, para 113.

<sup>599</sup> Also see UNCTAD (1999), 23-24.

<sup>600</sup> Also see UNCTAD (2012), 104-105.

<sup>601</sup> Picherack (2008), 258

<sup>602</sup> UNCTAD (2012), 105.

<sup>603</sup> *El Paso Energy International Company v. Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011.

<sup>604</sup> *Id.*, para 517.

<sup>605</sup> *Id.* The tribunal didn’t find individual regulatory measures taken by Argentina in response to the economic crisis that it suffered in violating the FET provision. However, held that cumulative effect of these regulatory measures results in violation of the FET provision. This is an indirect way of finding changes in regulatory framework as violation of the FET provision even when these changes were made to respond to severest economic crisis faced by Argentina.

on how this arbitral discretion has been exercised in other IIAs to understand the interpretations that can be adopted for FET standard in Indian IIAs.<sup>606</sup>

There is enough literature to show that arbitration tribunals have interpreted FET standard to include - denial of justice and due process; lack of arbitrariness and non-discrimination; and legitimate expectations (including transparency and stability of legal framework).<sup>607</sup> Out of these concepts, legitimate expectations poses the main challenge because in many cases host country's regulatory measure was found violating the FET standard and hence illegal because of the failure to honour investor's legitimate expectations.<sup>608</sup> Hence the concept of legitimate expectations requires to be understood in detail.

### Legitimate expectations

Legitimate expectations is a concept used in domestic administrative legal regimes of many countries though without a common settled understanding. For example, in Canadian administrative law, a legitimate expectation is limited to expectations of due-process in decision making.<sup>609</sup> In Indian administrative law, as discussed later in the chapter, legitimate expectation can be one of the grounds for judicial review but the granting of relief is very much limited.<sup>610</sup>

The preliminary point to note about legitimate expectations is that IIAs including Indian IIAs do not contain this term. Nevertheless, arbitral tribunals have made legitimate expectations an integral part of the FET provision so much so that it has '*become ubiquitous in IIA claims and awards*'.<sup>611</sup> One is unsure of the source of legitimate expectations in IIAs. Some argue that the source of legitimate expectations in FET is the doctrine of legitimate expectations in

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<sup>606</sup> In this regard, also see the arguments that in order to find the normative content of the FET standard, one has to refer to the decisions of other ITA tribunals because traditional means of interpretation given in Articles 31 and 32 of the VCLT are not useful – Schill (2011), 1092.

<sup>607</sup> See Dugan *et al* (2008), 504-531; Newcombe and Paradell (2009), 274-288; Salacuse (2010), 228-243; Dolzer and Schreuer (2008); McLachlan *et al* (2007) 226-247; Vandevelde (2010)

<sup>608</sup> The *Saluka* tribunal termed legitimate expectations as the dominant standard under the FET provision – see para 302. This has been critiqued by Fietta (2006), 397.

<sup>609</sup> Newcombe and Paradell (2009), 280. For in-depth discussion on legitimate expectations in administrative law see – S Schonberg (2000) *Legitimate Expectations in Administrative Law* (OUP: Oxford).

<sup>610</sup> *MS Sethi Auto Service v Delhi Development Authority*, (2009) 1 SCC 180, paras 24-26. Also see the discussion later in the chapter.

<sup>611</sup> Newcombe and Paradell (2009), 279. Also see Westcott (2007), 414.

domestic law like Professor Walde's separate opinion in *International Thunderbird* case;<sup>612</sup> some argue that the basis of legitimate expectation is general principles of law.<sup>613</sup> However, this has been questioned by scholars like Sornarajah arguing that as a general principle legitimate expectation provides only procedural protection and not substantive remedies.<sup>614</sup> Arbitrator Pedro Nikken, in his separate opinion in *AWG v Argentina*, posed a serious challenge to the concept of legitimate expectations as part of the FET provision. Arbitrator Nikken said '*the assertion that fair and equitable treatment includes an obligation to satisfy or not to frustrate the legitimate expectations of the investor at the time of his/her investment does not correspond, in any language, to the ordinary meaning to be given to the terms "fair and equitable."* Therefore, prima facie, such a conception of fair and equitable treatment is at odds with the rule of interpretation of international customary law expressed in Article 31.1 of the Vienna Convention on the Law of Treaties (VCLT). In addition, I think that the interpretation that tends to give the standard of fair and equitable treatment the effect of a legal stability provision has no basis in the BITs or in the international customary rules applicable to the interpretation of treaties.'<sup>615</sup>

The debate does not end on whether legitimate expectation is part of the FET provision. Even if one were to assume that legitimate expectation is part of the FET provision, the larger issue is about the meaning of 'legitimate expectation'. As the discussion below will show, different arbitral tribunals have given different meanings to this term, which has created a confusion regarding its meaning.<sup>616</sup>

One of the earlier cases which highlighted the concept of legitimate expectations as part of the FET provision is *Tecmed v Mexico*. In this case the tribunal said – *The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments... to be able to plan its*

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<sup>612</sup> Also see Fietta (2006), 376-378; McLachlan *et al* (2007), 234.

<sup>613</sup> See Vicuna (2005).

<sup>614</sup> Sornarajah (2010), 354-355.

<sup>615</sup> Separate Opinion of Arbitrator Pedro Nikken in *AWG v Argentina*, para 3. Also, Qureshi and Ziegler state that '*the notion of "legitimate expectations" as such and what can be their basis is controversial in itself*' - Qureshi and Ziegler (2011), 509.

<sup>616</sup> See Fietta (2006), 393 pointing to divergent and ambiguous explanation of three tribunals – *Methanex*, *Saluka* and *International Thunderbird Gaming Corporation v United Mexican States*, UNCITRAL, 26 January 2006. Also see Qureshi and Ziegler (2011), 509 who state that interpretation of the FET provision by different tribunals differs.

*investment and comply with such regulations.*<sup>617</sup> This makes legitimate expectation an overly expansive, unrealistic, catch-all phrase for all regulatory measures of the host state and has been criticised.<sup>618</sup> The *Tecmed* ruling links legitimate expectations with stability and continuance of the regulatory framework in place when the investment was made. This is so even if the host country didn't make any assurance to continue with the regulatory regime nor the investor has any legal entitlement in the host country's domestic law for the continued existence of the regulatory regime.<sup>619</sup> For example, in *Occidental v Ecuador*, although Ecuador had not given any assurance regarding the continuation of the legal regime based on which the investment was made, the tribunal held that Ecuador had violated the FET standard by changing the legal and regulatory regime that existed at the time when investment was made.<sup>620</sup> The tribunal, in yet another instance of relying on broad preambular language, reached the conclusion that stability of legal and business framework is an essential part of the FET standard.<sup>621</sup> The same approach was followed in *CMS v Argentina* and *Enron v Argentina* where Argentina's measures adopted to tackle a massive financial crisis were held as violating the regulatory framework in place when the investment was made and hence a breach of legitimate expectations.<sup>622</sup> An extremely expansive interpretation of the notion of legitimate expectations has been recently given by an arbitral tribunal in *Walter Bau AG v Thailand*<sup>623</sup> where it was held that the foreign investor had a legitimate expectation to have a reasonable rate of return from an investment project even if the host state had not made any such assurance.<sup>624</sup> Thus, this case links legitimate expectations to the subjective expectations of the foreign investor.<sup>625</sup>

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<sup>617</sup> *Tecmed*, para 154.

<sup>618</sup> *MTD Equity v Chile* (Annulment Proceeding), para 67; Douglas (2006), 28; Ryan (2008), 739-740; Dugan *et al* (2008), 513. Also see *AWG v Argentina*, which admits that certain broad elements of the *Tecmed* tribunal have been criticised – para 224. On the issue of lack of transparency violating the FET standard also see - *Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No ARB/97/7, para 83.

<sup>619</sup> Bonnitcho (2011). Also see Montt (2009), 360-362.

<sup>620</sup> *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, 1 July 2004, para 184.

<sup>621</sup> *Id*, para 183.

<sup>622</sup> *CMS v Argentina*, paras 274-277; *Enron v Argentina*, paras 264-267. For a critique of the *CMS* tribunal ruling that emphasised on 'stability in the regulatory framework see – Costamagna (2006), 9; Mayeda (2007), 278. Also see UNCTAD (2012), 66-67. Other cases that link investor's expectations with stability in the overall legal framework – *Duke Energy Electroquil Partners v Republic of Ecuador*, ICSID Case No. ARB/04/19, 18 August 2008, para 340; *PSEG v Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, paras. 252–253.

<sup>623</sup> *Walter Bau AG v The Kingdom of Thailand*, UNCITRAL Arbitration Rules, Award, 1 July 2009.

<sup>624</sup> *Id*, para 12.2 and 12.3

<sup>625</sup> Bonnitcho (2011), 7.

In contrast to these rulings, some other arbitral tribunals have concurred with the host state amending its regulatory framework. For example, the *Parkerings* tribunal denied violation of legitimate expectations because the state did not give any explicit or implicit promise that the legal framework would remain unchanged.<sup>626</sup> The tribunal also stated ‘*It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.*’<sup>627</sup> Recently, the ITA tribunal in *Impregilo v Argentina* said that ‘*The legitimate expectations of foreign investors cannot be that the State will never modify the legal framework, especially in times of crisis, but certainly investors must be protected from unreasonable modifications of that legal framework.*’<sup>628</sup> This standard is less strict in comparison to what *Tecmed* and *Occidental* tribunals have said. Nevertheless, the statement that ‘investors must be protected from unreasonable modifications’ of the legal framework is contentious. It is not clear what is meant by ‘unreasonable modifications’.<sup>629</sup>

Likewise, some ITA tribunals have held that legitimate expectations are subject to certain requirements.<sup>630</sup> Thus, expectations are considered to be legitimate and reasonable if they are based on specific unilateral assurances given by the host state to the foreign investor.<sup>631</sup> For example, the *Parkerings* tribunal said that ‘*the expectation is legitimate if the investor received an explicit promise or guarantee from the host state, or if implicitly, the host state made assurances or representation that the investor took into account in making the investment.*’<sup>632</sup> Similarly, in *Thunderbird v Mexico*, the arbitral tribunal held that legitimate expectations relates ‘*to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could*

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<sup>626</sup> *Parkerings* tribunal, para 334.

<sup>627</sup> Also see *BG Group v Argentina*, para 298; *Lemire v Ukraine*, para 285.

<sup>628</sup> *Impregilo v Argentina*, ICSID Case No. ARB/07/17, 21 June 2011, para 291.

<sup>629</sup> In *Impregilo v Argentina*, the tribunal held that Argentina’s changes in the regulatory framework were unreasonable because it failed in restoring an equilibrium, which was disturbed due the emergency legislation enacted by Argentina in response to the financial crisis – para 330.

<sup>630</sup> UNCTAD (2012), 67.

<sup>631</sup> *Methanex Corporation v. United States of America*, UNCITRAL, (NAFTA), Final Award, 3 August 2005, Part IV, Chapter D, page 5, para 7.

<sup>632</sup> *Parkerings* tribunal, para 331. Also see Dugan *et al* (2008), 518-519.



cause the investor (or investment) to suffer damages’.<sup>633</sup> The *Thunderbird* tribunal also emphasised on ‘detrimental reliance’ as an integral part of a claim of violation of legitimate expectation.<sup>634</sup> On the other hand, it has been argued that ‘detrimental reliance’ should not be strictly required to establish legitimate expectation.<sup>635</sup>

The tribunal in *Duke Energy v Ecuador* also stated that for expectations to be reasonable they must arise ‘from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest’.<sup>636</sup> The tribunal also stated two more factors that need to be taken into account in deciding whether investor’s expectations are reasonable - first; facts surrounding the investment; second, political, cultural, socioeconomic and historical conditions prevailing in the host country.<sup>637</sup> The reference to take into account the second point to determine whether the expectations of the investor are reasonable allows taking into account the regulatory powers of the host country while deciding whether the expectations of the investor are legitimate. The same point was made by the *Saluka* tribunal more directly stating that one of the requirements for an investor’s expectation to be reasonable is to weigh it against the host country’s regulatory power.<sup>638</sup>

As against the above mentioned cases that base legitimate expectations on specific unilateral assurances of the host state, some ITA tribunals seem to root the legitimacy of expectations into legal entitlements that can be enforced by law under the laws of the host state and not on unilateral assurances given by the host state to the foreign investor.<sup>639</sup> For example, in *Enron v Argentina* and in *LG&E v Argentina*, Argentina didn’t make any specific representations to

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<sup>633</sup> *Thunderbird*, para 147. Also see *Waste Management v Mexico*, ICSID Case No. ARB(AF)/00/3, para 98; *Metalclad Corp v United Mexican States*, ICSID Case No ARB(AF)/97/1, 30 August 2000, para 148; *National Grid v Argentina*, para 173.

<sup>634</sup> *Thunderbird*, para 147. It has also been argued that ‘detrimental reliance’ was pointed out by the tribunal in *Biwater v Tanzania* also – see Yost (2010). Also see *AWG v Argentina*, para 226;

<sup>635</sup> Snodgrass (2006), 45. Also see Newcombe and Paradell (2009), 285 who argue that ‘A breach of fair and equitable treatment is more likely to arise where the state has made specific representations about the use or enjoyment of the rights that the investor has acquired and where the investor has detrimentally relied on those representations’. This shows that a breach of legitimate expectation can also arise even in those situations where there is no ‘detrimental reliance’. Also in *MTD v Chile*, though the foreign investor argued for ‘detrimental reliance’ as part of the legitimate expectation claim, it was not emphasized by the tribunal in its analysis of legitimate expectation.

<sup>636</sup> *Duke Energy v Ecuador*, para 340

<sup>637</sup> *Id.*

<sup>638</sup> *Saluka*, para 305-306. The arbitral tribunal also stated in *National Grid v Argentina* that for expectations to be legitimate and reasonable, the context in which the measures were adopted (referring to Argentina’s severe economic crisis) should be taken into account – para 180. Also see *Total SA v Argentina*, ICSID Case No. ARB/04/01, paras 113-123. Also see Salacuse (2010), 233; McLachlan *et al* (2007), 234-235, 239.

<sup>639</sup> Bonnitcha (2011). Also see UNCTAD (2012), 69.

the foreign investors.<sup>640</sup> Likewise, the recent arbitral decision in *AWG v Argentina* held that expectations generated through a contract (distinguishing it from expectations generated by unilateral state assurances) which forms the basis of foreign investment and which is enforceable as per law would be legitimate.<sup>641</sup> Similarly, in *BG v Argentina*, the tribunal held that apart from specific commitments made by Argentina to the foreign investor, the regulatory framework that was guaranteed by Argentina to investor was of particular importance.<sup>642</sup> The tribunal held that the investor could reasonably rely on this regulatory framework, which Argentina violated and hence violated the principles of stability and predictability, which are an integral part of the FET provision.<sup>643</sup>

Another important case involving contractual relationship between the host state and the foreign investor is *Eureko BV v Poland*.<sup>644</sup> In this case, Poland was found guilty for violating the legitimate expectation of the investor that he would have acquired majority stake in the company through a public offering, which never took place.<sup>645</sup> This ruling has been criticised because of its sweeping requirement of contractual stability.<sup>646</sup> In contrast to *Eureko v Poland*, in some other cases such as *Total v Argentina*,<sup>647</sup> tribunals have adopted a more differential approach (giving deference to the host state) in judging the question whether breach of the contract violates the legitimate expectation of the investor.<sup>648</sup>

### Legitimate Expectation in Indian law

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<sup>640</sup> UNCTAD (2012), 69.

<sup>641</sup> *AWG v Argentina*, para 231.

<sup>642</sup> *BG v Argentina*, para 305

<sup>643</sup> *Id*, para 307. Also see *MCI Power Group v Republic of Ecuador* ICSID Case No ARB/03/6, Award, 31 July 2007, para 278; *Suez, Sociedad General de Aguas de Barcelona and Vivendi Universal v Argentine Republic* ICSID Case No ARB/03/19. Also see *El Paso v Argentina*, para 513. Basing legitimate expectations on specific enforceable contracts entered into between the host state and foreign investor raise the question whether legitimate expectations acts like an umbrella clause. It has been argued that if legitimate expectations are based on legally enforceable contracts, then simple breaches of the contract will not amount to frustration of the investor's legitimate expectations but only those breaches that are an attribute of host state's sovereign power – See Salacuse (2010), 236.

<sup>644</sup> Klager (2011), 181.

<sup>645</sup> *Eureko v Poland*, paras 231-235.

<sup>646</sup> Klager (2011), 182. Also see Douglas (2006), 41-42; Fietta (2006), 390 – pointed out the ambiguity in the tribunal's analysis.

<sup>647</sup> *Total S A v Argentina*, ICSID Case No. ARB/04/1, para 123.

<sup>648</sup> Also See *Waste Management v Mexico*; *Parkerings-Compagniet AS v Lithuania*; *Impregilo SpA v Pakistan*.

The above discussion on legitimate expectations demonstrates that this concept, as developed by ITA tribunals, goes very far in comparison to the understanding of legitimate expectations in Indian law. To start with, legitimate expectations in India cannot be used against the power of the legislature to make new laws, repudiate or amend existing laws even if an individual had relied on the previous legal framework and the changed situation is to her detriment.<sup>649</sup> Legitimate expectation has been recognised by Indian courts as a ground for judicial review for administrative actions.<sup>650</sup> The courts have recognised that legitimate expectation arises because of the representation or past conduct or practice of the state and that anyone relying on this doctrine will have to show reliance on the said representation and detriment due to the denial of the expectation.<sup>651</sup>

The law has been very clearly laid down by the Supreme Court of India in a recent case and deserves to be quoted in full.

*‘...a case for applicability of the doctrine of legitimate expectation, now accepted in the subjective sense as part of our legal jurisprudence, arises when an administrative body by reason of a representation or by past practice or conduct aroused an expectation which it would be within its powers to fulfill unless some overriding public interest comes in the way. However, a person who bases his claim on the doctrine of legitimate expectation, in the first instance, has to satisfy that he has relied on the said representation and the denial of that expectation has worked to his detriment. The Court could interfere only if the decision taken by the authority was found to be arbitrary, unreasonable or in gross abuse of power or in violation of principles of natural justice and not taken in public interest. But a claim based on mere legitimate expectation without anything more cannot ipso facto give a right to invoke these principles. It is well settled that the concept of legitimate expectation has no role to play where the State action is as a public policy or in the public interest unless the action taken amounts to an abuse of power. The court must not usurp the discretion of the public authority which is empowered to take the decisions under law and the court is expected to apply an objective standard which leaves to the deciding authority the full range of choice which the legislature is presumed to have intended. Even in a case where the decision is left*

<sup>649</sup> See *S S Theatre v Government of Tamil Nadu* AIR 1992 SC 999.

<sup>650</sup> On legitimate expectations in Indian administrative law See - *Union of India v Hindustan Development Corporation* (1993) 3 SCC 499; *National Buildings Construction v S Raghunathan and Others* (1998) 7 SCC 66; *Punjab Communication v Union of India* (1999) 4 SCC 727; *Bannari Aman Sugars v Commercial Tax Officer* (2005) 1 SCC 625; *Jitendra Kumar v State of Haryana* (2008) 2 SCC 161.

<sup>651</sup> *M S Sethi Auto Service Station v Delhi Development Authority* (2009) 1 SCC 180

entirely to the discretion of the deciding authority without any such legal bounds and if the decision is taken fairly and objectively, the court will not interfere on the ground of procedural fairness to a person whose interest based on legitimate expectation might be affected. Therefore, a legitimate expectation can at the most be one of the grounds which may give rise to judicial review but the granting of relief is very much limited.<sup>652</sup> This 2008 ruling was reaffirmed by the Supreme Court of India in 2011 in *APM Terminals v Union of India*<sup>653</sup> stating that where state action is based on public policy and public interest, the concept of legitimate expectation has no role to play unless state's action amounts to abuse of power.<sup>654</sup>

This passage also makes it clear that a claim based on legitimate expectation can be set aside if public interest is involved.<sup>655</sup> In other words, if an investment has been made based on the promise or specific assurances given by the executive or administrative bodies, change in the policy shall not violate legitimate expectations even if it is to the detriment<sup>656</sup> of the investor if the change is due to a public interest. Further, Indian courts have held that deference should be provided to the executive or administrative bodies in deciding what public interest is and courts must step in only if there is a gross abuse of power.<sup>657</sup> In this regard, the preferred test is the *Wednesbury* test of reasonableness.<sup>658</sup>

The discussion on legitimate expectations in Indian law shows that while an Indian investor can rely on the doctrine of legitimate expectations in limited circumstances; a foreign investor, because of the expansive interpretations developed by arbitral tribunals, can rely on legitimate expectation not only to challenge India's administrative decisions but even changes in the legislative and regulatory framework.<sup>659</sup> This gives foreign investors an advantage over Indian investors.

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<sup>652</sup> *Id.*, 24-26.

<sup>653</sup> *APM Terminals v Union of India* (2011) 6 SCC 756

<sup>654</sup> *Id.*, para 64.

<sup>655</sup> Also see *Punjab Communication v Union of India*; *Union of India v Hindustan Development Corporation*; *MRF v Assistant Commissioner (Assessment) Sales Tax and Others* (2006) 8 SCC 702.

<sup>656</sup> On the issue of detriment see – *National Building Construction v S Raghunathan* AIR 1998 SC 2776.

<sup>657</sup> India's noted Constitutional scholar, Professor M P Singh argues that '*In principle courts are not expected to take up policy matters but even if they do so they do it in a very narrowly tailored exceptional situation where the policy is clearly against the Constitution or its core values such as the fundamental rights or human dignity*' – Singh (2008), 200.

<sup>658</sup> *Associated Provincial Picture Houses Ltd. v. Wednesbury Corpn.*, (1948) 1 KB 223. See *Canara Bank v V K Awasthy* (2006) 1 SCC 430. Also see Pai (2008), 15; Massey (2008), 386-392.

<sup>659</sup> Such debates on how expansive interpretation of the FET standard in IIAs give foreign investors stronger rights in comparison to national companies are also happening in the United States – See – Stumberg (2009).

## Critical Review of Legitimate Expectations

Most arbitral tribunals refer to legitimate expectation as part of the FET provision without any clear doctrinal basis. The conclusion that legitimate expectation is part of the FET provision is reached not by using treaty interpretation rules but by relying on past arbitral awards even though these awards are not binding. Further, ITA tribunals are at variance in deciding when violation of legitimate expectations takes place. While there are some cases that talk of deciding the claims on violation of legitimate expectations by taking into account the host state's regulatory power<sup>660</sup>, there are also cases, which have interpreted legitimate expectations broadly indicating an undue restriction on host state's regulatory power.<sup>661</sup> It is important to remember that Argentina adopting measures to protect itself from an extraordinary economic crisis was found guilty of violating the FET standard.<sup>662</sup> If the Argentinean situation was to be judged under the Indian jurisprudence, such an extraordinary economic crisis would have been a reason enough to trump any claim of violation of legitimate expectation.

This shows that an ITA tribunal will enjoy a wide degree of discretion if it was to interpret the FET standard in the 'model-IIA' and 'modified-model IIA' FET formulations. This arbitral discretion can be exercised to make findings similar to the ones made in *Tecmed*, *MTD*, *Occidental*, *CMS*, *Eureka* or *Walter Bau*, which will adversely impact India's exercise of regulatory power. In light of the discussion on the context and the object and purpose of 'model-IIA' and 'modified-model IIA' FET formulation in Indian IIAs, an expansive interpretation of the FET standard in favour of the foreign investor is plausible.<sup>663</sup> On the other hand, an ITA tribunal may adopt a *Saluka* or a *Total* type analysis giving due

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<sup>660</sup> Cases such as *Saluka*, *Parkerings* discussed above. Also see Yannaca-Small (2008), 126-128.

<sup>661</sup> Also see Lowe (2002), 455; Miles (2010), 42-44; Ryan (2008), 738-742; Mayeda (2007). Even supporters of the investment treaty arbitration agree that there have been some far-reaching interpretations of what may be required by the host state as part of the fair and equitable treatment standard - See Reinisch (2009), 903. Also see *El Paso v Argentina*, paras 341-346.

<sup>662</sup> In this regard it is interesting to note that in *National Grid v Argentina* the tribunal, in view of the measures adopted by Argentina in the extreme economic situation it faced, held that Argentina was not guilty of violating the FET standard when it took these measures and hence modified the legal regime but when it required the claimant to renounce its legal remedies – see para 180. In this regard this case is different from other Argentinean cases where adoption of measures changing the legal regime were held to be in violation of the FET standard. Also see Vandevelde (2010), 76-77. Also see David Schneiderman's criticism of the expansive interpretation adopted by arbitral tribunals of the FET standard against Argentina – Schniederman (2008), 98-102.

<sup>663</sup> See Choudhary (2005), 318. Also see *Pope & Talbot*, where the tribunal referred to NAFTA's objective being to create an investment climate that is hospitable to foreign investors. For a criticism of this see Sornarajah (2007), 165, 174, 176.

weightage to India's regulatory power in determining whether India has violated the FET provision.

Stability and predictability in the regulatory framework are important for foreign investment. However, linking legitimate expectation to stability and predictability of the legal and regulatory framework in a manner where the host country finds it difficult to change its regulatory framework is particularly problematic. A multi-cultural, multi-ethnic, multi-religious country like India with high income-inequalities has to deal and resolve all kinds of complex problems and multitude competing interests between different stakeholders. Thus, it cannot afford such an expansive interpretation of legitimate expectations. India opposed the broad *Tecmed* standard of stability in the regulatory and legal framework in *White Industries v India*.<sup>664</sup> India argued against legitimate expectations being treated as an independent treaty standard.<sup>665</sup> India preferred a narrow definition of legitimate expectations limited to application of due process in administrative decision making, consistent application of law and with representations made to the foreign investor, which are specific enough to justify reliance.<sup>666</sup> India also argued that these expectations should be reasonable based on objective criteria as against vague and general representations giving rise to subjective expectations.<sup>667</sup> A country of India's size and diversity will require sufficient regulatory flexibility to evolve, change, and adapt its legal and regulatory framework based on new challenges it faces and also in an effort to find new and better ways to govern itself.

The most apt example that captures the problems related to a very high standard of stability and predictability in the regulatory framework is related to India's taxation law on taxing offshore transactions involving capital assets not situated in India but having a link with India. This issue involved imposing a capital gains tax on Vodafone, which was reversed by the Supreme Court of India as mentioned in chapter 2. India wishes to reverse the ruling of the Supreme Court by amending its tax law to provide for imposing tax on such Vodafone-like transactions retrospectively. It wants to bring about this amendment so as to maximise its revenue collection.<sup>668</sup>

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<sup>664</sup> *White Industries Australia v India*, UNCITRAL (Final Award), 30 November 2011, para 5.2.1

<sup>665</sup> *Id* para 5.2.3.

<sup>666</sup> *Id*.

<sup>667</sup> *Id*. Also see para 5.2.4. Also see Newcombe and Paradell (2009), 281-282.

<sup>668</sup> Van Harten has argued that governments are often required to make difficult choices when exercising public authority and their policy choices may in certain cases appear to misapprehend facts – See Van Harten (2007), 89.

Other contemporary examples include the issue of FDI in multi-brand retail. The present government is planning to open the multi brand retail sector for FDI;<sup>669</sup> however, this is being opposed by the principal opposition party and also by other political parties on ideological and other grounds. It is quite possible that the policy of FDI in multi-brand retail, if adopted, may be reversed in future, based on which political party is voted to power by the people of India or even in situations where the Indian government thinks that the policy of allowing FDI in multi-brand retail is not yielding the desired results and hence the need to change the policy.<sup>670</sup> Similarly, India is contemplating to change its land acquisition law due to several protests and agitations by farmers who have been arguing that the existing land acquisition law is inadequate in protecting their interests.<sup>671</sup> The proposed law will increase the compensation to be paid to farmers and land owners manifold.<sup>672</sup> Such a legislative change is meant to address the aspirations of the farming community so that benefits of land acquisition percolate to all sections of the society. However, increasing the compensation manifold is certainly going to have an adverse impact on the industry including foreign corporations.

Adopting such policy and legal changes is a function of India's sovereignty provided such changes are not arbitrary and do not constitute a gross abuse of public power. However, viewing such reversals of policy or changes in law from the *Tecmed* standard of certainty and predictability in the regulatory framework, will adversely impact India's regulatory power. Even if one were to evaluate such measures in view of the not so strict standard provided by the *Impregilo* tribunal, these changes will have to pass the test of not being 'unreasonable modifications' in the regulatory framework.

Even if an ITA tribunal adopts a more deferential *Total-like* approach and takes India's regulatory power into account to determine violation of legitimate expectations, one is unsure how this extremely difficult balance will be struck.<sup>673</sup> Some tribunals have stated that a

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<sup>669</sup> FDI in Multi Brand Retail Still on Government's Mind: FM, The Times of India, 24 December 2011 available at <http://timesofindia.indiatimes.com/business/india-business/FDI-in-multi-brand-retail-still-on-govts-mind-FM/articleshow/11224948.cms>

<sup>670</sup> Van Harten has argued that governments are often required to make difficult choices when exercising public authority and their policy choices may in certain cases appear to misapprehend facts – See Van Harten (2007), 89.

<sup>671</sup> See Dhru (2010).

<sup>672</sup> See the Draft National Land Acquisition and Rehabilitation and Resettlement Bill, 2011 available at <http://rural.nic.in/sites/downloads/policies/Final.pdf>

<sup>673</sup> See Klager (2011), 187.

reasonableness test should be used.<sup>674</sup> Some argue that this balancing should be done by using the test of proportionality.<sup>675</sup> In other words, the arbitral tribunal should carry out the three-step proportionality test involving the suitability of the measure, necessity (least restrictive test) and weighing and balancing host country's regulatory power with the effect on foreign investment (proportionality *stricto sensu*) to decide whether the regulatory measure is legal or in violation of the host state's obligation to treat foreign investment fairly and equitably.<sup>676</sup> Recently, the arbitral tribunal in *Lemire v Ukraine* mentioned the proportionality test in finding out the violation of FET standard by stating that one of the countervailing factors that should be taken into account in determining FET violation is '*the State's sovereign right to pass legislation and to adopt decisions for the protection of its public interests, especially if they do not provoke a disproportionate impact on foreign investors*'.<sup>677</sup>

As it has also been discussed in other chapters of the thesis (chapters 3 and 6), the proportionality test gives much discretion to the arbitrator to decide whether host state's regulation, adopted in public interest, trumps the adverse impact on foreign investment. The tribunal will decide this by weighing and balancing public interest with adverse impact on foreign investment. An outcome of this weighing and balancing could be that harm caused to foreign investment outweighs the public interest and hence the conclusion that India has violated the FET provision. Such an outcome will adversely affect the exercise of India's regulatory power. Also, as discussed in chapter 3, whether an ITA tribunal is qualified to make such policy choices, by stepping in the shoes of the Indian executive and legislature, is a moot point.

### *Equating Approach*

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<sup>674</sup> See the discussion in Klager (2011), 242-244 and Kingsbury and Schill (2009), 37-38. Cases like *Saluka* suggest a reasonableness test where the host state's conduct should bear a reasonable relationship between to some rational policy – see paras 309 and 460. Also see McLachlan *et al* (2007), 245.

<sup>675</sup> Schill (2010), Snodgrass (2006), 45-48. Also see Montt (2009), 365-366; and the discussion on the proportionality test in the chapters on expropriation and the Non Precluded Measures provision.

<sup>676</sup> Also see Klager (2011), 245.

<sup>677</sup> *Lemire v Ukraine*, para 285. Also see dissenting ruling of Prof T Walde in *Thunderbird*, para 30. An abridged proportionality analysis was also applied in *EDF Services Ltd v Romania*, ICSID Case No. ARB/05/13, 8 October 2009 – see para 293.



The equating approach to interpret the FET provision implies that such a provision in the IIAs reflects the MST of aliens under CIL. This approach has been supported either by the text of the treaty or by using other treaty interpretation rules like Article 31(3) (c) of the VCLT.

Some arbitral tribunals have held that the FET standard in the IIA reflects the MST of aliens under CIL by undertaking a textual analysis of the FET provision at hand. The arbitral tribunal in *MCI v Ecuador*<sup>678</sup> held that FET provision in the IIA obliges the countries to respect standard of treatment required by CIL, which arise from the repeated, general and constant practice of the state observed because the country is ‘*aware that it is obligatory*’.<sup>679</sup> The FET provision that had to be interpreted read as follows – ‘*Investments shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law*’. This FET provision refers to ‘international law’. Such a reference in the provision was used by the *MCI* tribunal, pursuant to use of treaty interpretation methodology, to bring in the notion of CIL in interpreting the FET provision.<sup>680</sup> Similarly in *Genin v Estonia*<sup>681</sup> it was held that the requirement to provide fair and equitable treatment under international law means the obligation to provide an international minimum standard devoid of host state’s law but that is indeed a *minimum* standard.<sup>682</sup> In this case also, the FET provision had a reference to ‘international law’. Article II (3) (a) of the US-Estonia IIA, apart from providing for fair and equitable treatment, also states that ‘*no investment shall be accorded treatment less favourable than that required by international law*’. On the other hand, the ITA tribunal in *Total v Argentina*, interpreted the FET provision in France-Argentina IIA, which referred to ‘international law’ differently. The *Total* tribunal said that reference to ‘international law’ in the FET provision didn’t mean treatment required in conformity with MST of aliens under CIL.<sup>683</sup> According to the tribunal ‘international law’ in the FET provision meant referring to international law principles.<sup>684</sup>

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<sup>678</sup> *MCI Power Group v Ecuador*, ICSID Case No ARB/03/6, 31 July 2007.

<sup>679</sup> *Id.*, para 369.

<sup>680</sup> Also see Klager (2011), 58.

<sup>681</sup> *Alex Genin et al v Estonia*, ICSID Case No ARB/99/2, 25 June 2011.

<sup>682</sup> *Id.*, para 367.

<sup>683</sup> *Total v Argentina*, para 125.

<sup>684</sup> *Id.*

An important inference of holding that the FET provision reflects the MST of aliens under CIL, will be that whether the host country has violated the FET provision will depend on whether host country has violated a rule that is part of CIL.<sup>685</sup> This means that the threshold for the violation of the FET provision shall be higher in comparison to the threshold required for violation of the FET provision if its content is determined using the autonomous approach.<sup>686</sup> In *Genin v Estonia*, it was held that – ‘*Acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith*’.<sup>687</sup> A higher threshold for the violation of the FET provision will certainly allow host countries more regulatory power to pursue non-investment policies without worrying about the violation of the FET provision.

However, neither the ‘model-IIA’ or ‘modified-model IIA’ FET formulations, link FET with MST of aliens under CIL or have any reference to ‘international law’. In other words, there is no textual basis to use the equating approach to interpret the FET provision in these 66 Indian IIAs. The tribunal in *Enron v Argentina* also said that apart from treaties like NAFTA, which specifically link the FET standard with MST of aliens under CIL, the FET standard in other treaties is broader<sup>688</sup> - in other words, cannot be linked to MST of aliens under CIL.

In this regard, the role of Article 31(3) (c) of the VCLT, which states, ‘*relevant rules of international law applicable in the relations between the parties*’, becomes important.<sup>689</sup> It needs to be examined whether Article 31(3) (c) can be used to follow the equating approach in interpreting the FET provision in ‘model-IIA’ and ‘modified-model IIA’ FET formulations.

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<sup>685</sup> Picherack (2008), 258. Also see discussion on these issues in Sornarajah (2010), 351-354; Subedi (2008), 65-67; Klager (2011), 55-59.

<sup>686</sup> See *Loewen v United States*, para 132; *International Thunderbird v Mexico*, para 194; *Waste Management v Mexico*, para 98; *ADF Group v United States*, para 179; *Cargill v Mexico*, para 296. Also see *Glamis Gold v United States* para 616; *Saluka v Czech Republic*, paras 291-293. Compare paras 291 with 292-293 pointing to the ‘lower degree of inappropriateness’ to violate the FET standard in comparison to the customary international law standard. Also see Haeri (2010), 37-39.

<sup>687</sup> *Genin v Estonia*, para 367. Also see *MCI v Ecuador*, para 369.

<sup>688</sup> *Enron v Argentina*, para 258. Also see Ali and Tallent (2009), 209; Muchlinski (2009), 46-47. Also see *Glamis Gold v Mexico*, NAFTA Chapter 11 Arbitration Tribunal, 8 June 2009, para 606.

<sup>689</sup> In this regard, see the comments of P Sands that in actual practice Article 31(3) (c) has only been occasionally relied in judicial practice and there seems to be a general reluctance regarding its use – Sands

It has been argued that MST of aliens under CIL is a relevant rule under Article 31(3) (c), which should guide the determination of the nature of the FET standard.<sup>690</sup> One scholar relying on Article 31(3) (c) and also on Article 31(4) and 32 of the VCLT has argued that the FET standard cannot go beyond the international minimum standard.<sup>691</sup> However, the universal acceptance of MST of aliens under CIL is still uncertain and its content unknown.<sup>692</sup> The content of MST of aliens under CIL is as indeterminate<sup>693</sup> as the FET provision; hence how can one provision (FET in the IIA) be equal to something that is still largely unknown (MST of aliens under CIL) especially when the treaty does not provide for any such equating. More importantly, an indeterminate concept will fail to pass the test of ‘applicability’ ‘in the relations between the parties’ under Article 31(3) (c) of the VCLT.<sup>694</sup> In other words, since the content and existence of the MST of aliens under CIL remains equivocal, one is not sure whether Article 31(3) (c) of the VCLT can play a role in justifying the use of the ‘equating approach’ to determine the nature of the FET standard in the ‘model-IIA’ and ‘modified-model IIA’ formulations.

Another argument made in favour of equating the FET provision with MST of aliens under CIL is that since this term, historically, was extremely sensitive, developing countries like India may have preferred to use a politically neutral term in the form of FET to convey an acceptance of the international minimum standard.<sup>695</sup> However, in India’s case there is no evidence to support this argument. India copied the western model of investment protection treaties, which included the FET provision, in an effort to change its image from being unfriendly to foreign investment to being an attractive destination for foreign capital. Since the contracting country needed some assurance on treatment of its investment, Indian IIAs allowed introduction of the FET provision for investments as a treaty provision without any

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<sup>690</sup> Montt (2009), 303-306. It has been argued that although a customary law is ‘any relevant rule’ under Article 31(3) (c) of the VCLT, it is not the case that any existing customary law relevant to the issue at hand needs to be applied because the gaps in the treaty or indication towards different meaning may be deliberate - Paparinskis (2011), 301; Wood (2007), 361; McLachlan, (2008), 383; McLachlan *et al* (2007), 153. Also see Salacuse (2010), 151.

<sup>691</sup> Montt (2009), 303-306. Also see McLachlan (2008) on the role of Article 31(3) (c) of the VCLT in interpreting IIAs. Also see Picherack (2008), 263-264.

<sup>692</sup> Sornarajah (2004), 140-141; Sornarajah (2010), 345-354; Porterfield (2006), 81-84; Puvimanasinghe (2007), 87-93; Klager (2011), 50; McLachlan *et al* (2007), 204.

<sup>693</sup> UNCTAD (2012), 44.

<sup>694</sup> P Sands has argued that the difficulty in proving the applicability of the custom (since it is difficult to prove that a custom exists) will result in an Article 31(3) (c) argument failing – Sands (1999), 102. Also see Vasciannie (1999), 144; Klager (2011), 58-59.

<sup>695</sup> See the dissenting judgment of Arbitrator Pedro Nikken in *AWG v Argentina*, paras 12-15; Newcombe and Paradell (2009), 268.

intent of it reflecting MST of aliens under CIL.<sup>696</sup> For India, the main guiding principle for investment protection has generally been that foreign investment would get the same treatment as domestic investment and not as per some international minimum standard.<sup>697</sup> Thus, there was no conscious effort to incorporate the FET standard in its IIAs as a politically neutral term for MST of aliens under CIL. This is not surprising in view of the fact that India has always opposed the existence of such MST of aliens under CIL. Consequently, it is difficult to infer that FET in these 66 Indian IIAs equals the MST of aliens under CIL<sup>698</sup> (Also see the discussion in Section 4.3.3).

Therefore, in view of the arbitral jurisprudence discussed above, there is a much greater possibility of interpreting the ‘model-IIA’ and ‘modified-model IIA’ FET formulations in an autonomous manner not linked to the MST of aliens under CIL. This, depending on arbitral discretion, could result in interpretations giving precedence to investment protection over India’s regulatory power.

#### 4.3.2 Interpreting ‘Content-Indicative’ type FET formulation

The three ‘content-indicative’ Indian IIAs with Korea, Japan and Malaysia state that FET provision does not require treatment in addition to MST of aliens under CIL. The title of the provision containing the FET provision in the India-Malaysia IIA (Article 10.5) and India-Korea IIA (Article 10.4) is ‘minimum standard of treatment’ and not ‘promotion and protection of investment’. In India-Mexico IIA, the FET provision occurs under the heading ‘Minimum Standard of Treatment’ in Article 5, which is as follows.

- 1. Each Contracting Party shall accord to investments of investors of the other Contracting Party fair and equitable treatment and full protection and security.*
- 2. Each Contracting Party shall not deny justice to investments of investors of the other Contracting Party.*
- 3. For greater certainty:*

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<sup>696</sup> Interviews with Indian officials and treaty negotiators.

<sup>697</sup> Id.

<sup>698</sup> Also see Vasciannie (1999), 144; UNCTAD (1999), 39-40; Choudhary (2005), 301; Muchlinski (2007) 637-638; Salacuse (2010), 226-227; Klager (2011), 58-59.

- (a) the obligations set forth in paragraphs 1 and 2 above do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens; and*
- (b) a determination that there has been a breach of another provision of this Agreement, or of a separate international Agreement, does not establish that there has been a breach of this Article.*

India-Mexico IIA includes ‘denial of justice’ as part of the FET provision.

The preamble of the India-Malaysia, India-Korea, India-Japan IIAs refer to multiple values such as ‘rights to pursue economic philosophies suited to their development goals’; ‘rights to realise their national policy objectives’; and ‘optimal use of natural resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment’.<sup>699</sup> The preamble in the India-Mexico IIA is not as elaborate as three IIAs mentioned above; however, it does contain values like ‘economic prosperity’. Apart from this the treaty provisions in these IIAs also contain provisions that recognise the importance of exercise of regulatory power.<sup>700</sup> Thus, the context and the object and purpose of these three agreements are not just investment protection and promotion. These IIAs talk of achieving investment promotion and protection in a manner harmonious with India’s ability to exercise regulatory power.

The ‘content-indicative’ FET formulations resemble the FET formulation that exists in NAFTA after the FTC interpretation note. This note was a response to the *Pope and Talbot* ruling<sup>701</sup> through which NAFTA member countries intended that the FET standard incorporates customary international law standard and nothing more.<sup>702</sup> Though, the content of MST remains a moot point the understanding clearly seems to be that it is more stringent than an autonomous FET standard.<sup>703</sup>

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<sup>699</sup> The preamble in these three agreements is for the entire treaty and not just the investment chapter

<sup>700</sup> See the chapters 3 (Expropriation), 5 (Monetary Transfer Provision) and 6 (Non Precluded Measures) of the thesis.

<sup>701</sup> Newcombe and Paradell (2009), 272; Salacuse (2010), 225.

<sup>702</sup> Clodfelter (2009), 170. However, it has been argued that the FTC interpretation note has not brought any finality to the debate regarding the meaning of the FET standard in NAFTA because it does not define the content of the FET standard - Newcombe and Paradell (2009), 273.

<sup>703</sup> Sornarajah (2010)

Since FET provision in these IIAs is linked to MST of aliens under CIL, the ‘content-indicative’ FET formulations support adopting the ‘equating approach’ to interpret the FET provisions. Accordingly, the content of the FET provision will be determined by determining the content of the MST of aliens under CIL. This will require determining India’s consistent state practice and whether this practice is being followed because of a sense of legal obligation or not (*opino juris*). This will have to be factually ascertained.<sup>704</sup> In other words, to show that India has violated the FET provision, it will have to be shown that India has violated CIL. While ascertaining state practice is not so difficult, establishing *opino juris* is certainly challenging. The *Glamis* tribunal stated that the onus is on the claimant to establish a change in custom.<sup>705</sup>

In the context of NAFTA, different arbitral tribunals have provided different thresholds to determine whether a country has violated the MST of aliens under CIL. In *Glamis Gold v United States*, a NAFTA tribunal held that the *Neer* standard was still the relevant standard to determine whether a country has violated the MST of aliens under CIL.<sup>706</sup> This will require a very high threshold for the violation of the FET provision. Other NAFTA tribunals have held that MST of aliens under CIL has evolved beyond the *Neer* standard and that the threshold for the violation of the FET provision is not as high as the *Neer* standard.<sup>707</sup> However, even these tribunals have held that the threshold for the violation of the FET provision still remains high.<sup>708</sup> For example, the tribunal in *Waste Management v Mexico* stated that the FET provision will be violated if the host state’s conduct is arbitrary, grossly unfair, or involves lack of due process.<sup>709</sup> India supports the *Waste Management* tribunal’s approach of requiring a high threshold for the violation of the FET provision.<sup>710</sup>

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<sup>704</sup> *Cargill v United Mexican States*, ICSID Case No. ARB(AF)/05/2 (NAFTA), para 271; *Glamis Gold*, para 607.

<sup>705</sup> *Glamis Gold*, para 607.

<sup>706</sup> *Glamis Gold*, para 627. In this regard it is also important to note that the United States in the *Glamis Gold* case argued that MST of aliens under CIL includes three elements – internal security, compensation for expropriation, and denial of justice – See – Counter Memorial of the United States in *Glamis Gold* case available at <http://www.state.gov/documents/organization/73686.pdf>.

<sup>707</sup> UNCTAD (2012), 57-58. *Mondev* tribunal, para 116; *Tecmed*, para 153; *Waste Management*, para 98; *Merrill and Ring Forestry L P v Canada*, ICSID Administered Case, 31 March 2010, para 213. Also see *Chemtura Corporation v Canada*, Ad Hoc NAFTA Arbitration Under UNCITRAL Rules, 2 August 2010, para 215.

<sup>708</sup> *International Thunderbird v Mexico*; *Waste Management v Mexico*; *GAMI Investments v United Mexican States*, NAFTA Chapter 11 and UNCITRAL Arbitral Proceedings, 15 November 2004.

<sup>709</sup> *Waste Management v Mexico*, para 98. Also see Picherack (2008), 273.

<sup>710</sup> *India v White Industries*, para 5.2.2

A much lower threshold for the violation of MST of aliens under CIL was given by the NAFTA tribunal in *Merrill and Ring v Canada*. The tribunal made a distinction between evolution of minimum standard in a limited context as specified in the *Neer* context, on the one hand, and evolution of minimum standard in the context of business, trade and investment, on the other.<sup>711</sup> Giving an extremely expansive interpretation to FET, the tribunal held ‘*A requirement that aliens be treated fairly and equitably in relation to business, trade and investment [...] has become sufficiently part of widespread and consistent practice so as to demonstrate that it is reflected today in customary international law as opinio juris. In the end, the name assigned to the standard does not really matter. What matters is that the standard protects against all such acts or behavior that might infringe a sense of fairness, equity and reasonableness.*’<sup>712</sup> The *Merrill and Ring* tribunal significantly lowered the threshold for the violation of the FET provision. It gave a broader meaning to the FET provision notwithstanding the treaty clearly stating that it is no more than MST of aliens under CIL.<sup>713</sup> As per this approach, the MST of aliens under CIL has evolved so as to converge with the content of an autonomous FET standard as developed by arbitral jurisprudence. Thus, not just denial of justice and due process but even maintaining a transparent and predictable legal system and honouring the legitimate expectations of foreign investors are part of CIL.<sup>714</sup> Such an interpretation removes any distinction between the two formulations. Sir Ian Brownlie has criticised this tendency of some tribunals and writers to give the international minimum standard a very ambitious content.<sup>715</sup>

Adopting the *Merrill and Ring* approach to ‘content-indicative’ IIAs will make the difference between ‘content-indicative’ FET formulations and ‘model IIA’ and ‘modified model IIA’ FET formulations, redundant. As per the *Merrill and Ring* approach, FET in ‘content-indicative’ IIAs is to be expansively interpreted with lower threshold, which is same as would be the case for autonomous FET provision. This reasoning ignores the key differences in the context and the object and purpose of the two different types of IIAs. As it has been discussed above the context and the object and purpose of the Indian IIAs containing ‘model IIA’ and

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<sup>711</sup> *Merrill Ring v Canada*, para 205.

<sup>712</sup> *Merrill and Ring v Canada*,

<sup>713</sup> Also see Stumberg (2009) who notes that despite linking the minimum standard with customary international law arbitral tribunals continue to interpret the standard broadly.

<sup>714</sup> See *Occidental tribunal*, paras 190-191. It has been argued that transparency, stability and legitimate expectations as part of the FET standard are not ‘well grounded’ in customary international law – Yannaca-Small (2008), 130.

<sup>715</sup> Brownlie (2008), 526.

‘modified model IIA’ FET formulations is very different from the ‘content-indicative’ IIAs. To argue that in spite of this, FET standard in both types of IIAs has the same meaning is not persuasive. India has deliberately adopted a different formulation of the FET standard in the ‘content-indicative’ IIAs and hence the intent is to have a meaning different from the ‘model-IIA’ and ‘modified-model IIA’ FET formulations.

The discussion above once again demonstrates the existence of arbitral discretion even with respect to FET formulations where the FET provision is linked to MST of aliens under CIL. *Glamis* and *Merrill and Ring* approaches show the two extremes of this discretion. Hence, one is unsure which way arbitral discretion will be exercised for the ‘content-indicative’ FET formulations. The approach adopted by the *Merrill and Ring* tribunal is discussed further below under the ‘convergence approach’.

#### 4.3.3 Convergence Approach - Is providing fair and equitable treatment part of CIL for India?

Convergence approach signifies that the FET provision has become part of CIL. Hence, the content of an autonomous FET is identical to the MST of aliens under CIL. Some tribunals adopting the autonomous approach to interpreting the FET standard have asserted that the content of FET determined by adopting the autonomous approach also forms part of the MST of aliens under CIL.<sup>716</sup> For instance, the *CMS* tribunal after adopting the autonomous approach to FET interpretation and having determined that Argentina had violated the FET provision came to the conclusion that MST of aliens under CIL has evolved and is now same as the expanded and autonomous FET provision.<sup>717</sup> The tribunal reached to this conclusion in just three paragraphs.<sup>718</sup> Another way of stating this argument will be that countries are now under a customary international law obligation to provide fair and equitable treatment to foreign investors and the content of the FET will be determined by using the autonomous approach.<sup>719</sup> The central argument of those who make this assertion is that repeated appearance of the FET provision in IIAs over a period of time and by so many countries has

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<sup>716</sup> Picherack (2008), 258; Kill (2008), 864; Montt (2009), 298. Also see Haeri (2010), 35-42; Westcott (2007), 429-430.

<sup>717</sup> *CMS v Argentina*, paras 282-284.

<sup>718</sup> *Id.* Also see *Azurix v Argentina*, paras 361-372; *Rumeli Telekom v Kazakistan*, para 611; *Duke Energy v Ecuador*, para 337. Also see *Biwater v Tanzania*, para 529.

<sup>719</sup> On the issue of IIAs creating/influencing customary international law see – Lowenfeld (2003), 123; Schwebel (2004), 27; Alvarez (2009), 17; Klager (2011), 265-271; *Merril Ring v Canada*, para 211.



resulted in a metamorphosis of the FET provision into a customary international law principle.<sup>720</sup> This has been countered by other scholars who have argued that numerical explosion of IIAs cannot contribute to identifying the content of an international minimum standard because none of these IIAs give the content of that standard.<sup>721</sup> The content of the FET standard is still subject to a wide degree of debate not just amongst commentators but also among tribunals who have given the FET provision different meanings (issue discussed throughout the chapter).<sup>722</sup> Thus, how can a state have a customary international law obligation of a standard whose content is unknown? As Sornarajah has argued ‘*emptiness multiplied several times over can still produce only emptiness*’.<sup>723</sup>

The convergence approach suffers from a serious methodological flaw. It has been rightly argued that none of the tribunals that adopt the ‘convergence approach’ have shown that what is claimed to be part of CIL fulfils the conditions of consistent state practice and the fact that countries have been following such practices from a sense of legal obligation.<sup>724</sup> The tribunals reach this conclusion simply on the basis of the previous arbitral tribunals. For example, the tribunal in *Duke Energy v Ecuador* only cited *Azurix* and *CMS* tribunals as the basis to come to the conclusion that the FET standard has converged with the minimum standard.<sup>725</sup>

Adopting the convergence approach would put India under an obligation to treat Singaporean and Turkish investors fairly and equitably in the sense in which FET is understood in arbitral jurisprudence even if India’s IIAs with Singapore and Turkey do not contain the FET provision. Not just that, India will be bound to provide fair and equitable treatment to all foreign investors even in situations where India has not signed an IIA with their home countries.<sup>726</sup> In other words, proving fair and equitable treatment will become like a *de facto* multilateral obligation that India will owe to all foreign investors.

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<sup>720</sup> See the discussion in the works cited *Id.*

<sup>721</sup> Sornarajah (2010), 347; Faraque (2004), 292; Porterfield (2006), 81-82.

<sup>722</sup> Faraque (2004); Also see Porterfield (2006), 81-82.

<sup>723</sup> Sornarajah (2010), 347.

<sup>724</sup> Porterfield (2006), 103-104, Kill (2008), 864-865. Some arbitral tribunals like *Glamis Gold v United States*, para 602 and *Cargill v Mexico*, para 271 have highlighted this fundamental requirement in public international law. Also see Testimony of Robert Stumberg, Reform of Investor Protections, House Committee on Ways and Means, Subcommittee on Trade available at <http://waysandmeans.house.gov/media/pdf/111/stumberg.pdf>.

<sup>725</sup> *Duke Energy v Ecuador*, paras 336-337; Stumberg (2009)

<sup>726</sup> See Guzman (2009) who points out this consequence if IIAs establish a rule of customary international law.

It is useful to reflect on India's practice on this issue to show that India has looked at the FET provision merely as a treaty standard and nothing more. India resisted the attempt to have a multilateral agreement on investment under the aegis of the WTO. Thus, India refused to bind itself to multilateral rules on investment protection.<sup>727</sup> India, in its submission to the WTO, said that it has consciously adopted a bilateral model to undertake international investment commitments aimed at attracting investment flows.<sup>728</sup> While recording the salient features of Indian IIAs, signed till 1999, India listed FET under the heading of 'investment protection'.<sup>729</sup> It linked the FET provision to investment protection as a useful treaty standard at the bilateral level.<sup>730</sup>

India's opposition to a multilateral agreement on investment was reaffirmed by the Indian Commerce minister at the Seattle Ministerial meeting of the WTO.<sup>731</sup> The minister stated categorically that India does not subscribe to the view that a multilateral framework on investment is either necessary or desirable.<sup>732</sup> This position was repeated by subsequent Commerce ministers of different political parties at subsequent ministerial conferences of the WTO.<sup>733</sup> At the Cancun ministerial conference, held in 2003, Indian commerce minister, Arun Jaitley, stated that a multilateral agreement on investment '*will certainly curtail the policy space of developing countries*'.<sup>734</sup> India argued that bilateral IIAs on the basis of economic need are a much better way to attract FDI rather than agreeing to multilateral rules such as providing fair and equitable treatment to foreign investments of all WTO member countries.<sup>735</sup> This clearly shows that India has opposed any effort to be bound by investment protection rules multilaterally (FET provision becoming part of CIL will bind India multilaterally). It also signals India's intention to be bound by obligations like FET only in IIAs at the bilateral level where it has voluntarily undertaken to be bound by it and not otherwise.

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<sup>727</sup> India's submission to the WTO Working Group on the Relationship Between Trade and Investment, 13 April 1999, WT/WGT1/W/71.

<sup>728</sup> Id.

<sup>729</sup> Id.

<sup>730</sup> Id.

<sup>731</sup> Statement by Murali Maran (1999) Minister of Commerce and Industry, India, Ministerial Conference, World Trade Organization, WT/MIN(99)/ST/16.

<sup>732</sup> Id.

<sup>733</sup> Statement by Aurn Jiatly (2003) Minister of Commerce and Industry, India, Ministerial Conference, Cancun, World Trade Organization, WT/MIN(03)/ST/7.

<sup>734</sup> Id.

<sup>735</sup> India's Submission to the WTO, WT/WGT1/W/71. Also see Guzman (1998); Guzman (2009); Yackee (2009), 1552; Dumberry (2010), 691 for mounting a challenge to BITs becoming part of customary law. For a contrary view see Alvarez (2009), 17.

Further support for the argument that India looks at the FET provision in its IIAs purely for attracting foreign investments comes from the recent statement of India's Finance Minister.<sup>736</sup> While introducing the Indian IIA programme in the compendium of Indian IIAs, the minister stated that IIAs provide an enabling environment for flow of global investments by ensuring fair and equitable treatment on reciprocal basis.<sup>737</sup> This statement links FET to reciprocity where both India and its treaty partner country owe each other the obligation to treat each other's investment fairly and equitably. This reciprocal arrangement has its basis in the IIA. Stated differently, since the obligation of fair and equitable treatment is owed on a reciprocal basis, India does not owe this obligation to any foreign investment not falling under an IIA or if the IIA does not contain this provision.<sup>738</sup>

This clearly shows that FET provision in Indian IIAs is only a treaty standard and will bind India only in situations where India has voluntarily undertaken this obligation and not as a standard of CIL. At any rate, it is untenable to argue that India has an obligation under CIL to treat foreign investors fairly and equitably when what is fair and equitable standard still remains a moot issue.<sup>739</sup>

## ***SUMMARY***

FET provision is an important provision in Indian IIAs. This chapter discussed the FET provision in 71 Indian IIAs and found that in a very large number of these 70 IIAs there is no indication of the meaning of the FET provision. The use of treaty interpretation tools also do not give a definite meaning of this term although these rules lend weight to adopting interpretations that give precedence to investment protection over India's regulatory power. Further, the arbitral discussion on the FET provision undertaken to understand the meaning of the FET provision shows that arbitral tribunals have developed the concept of legitimate

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<sup>736</sup> Mukherjee (2011).

<sup>737</sup> *Id.*

<sup>738</sup> After a spate of arbitrations against India in the *Dabhol* dispute, there are indications that India started to realise that its present IIAs offer wide protection to investments and that there is a need to dilute some of these provisions. Hence, in its IIA with Singapore entered after the Enron debacle, India and Singapore agreed to omit the FET standard from the IIA. This marked a break in the practice of having FET standard in all IIAs, though this break was temporary.

<sup>739</sup> Also see Westcott (2007), 411.

expectations as part of the FET provision though the meaning of legitimate expectation amongst tribunals is different. Further, the arbitral understanding of legitimate expectations goes beyond the understanding of this term in Indian law. The chapter has also shown that whether the FET provision in Indian IIAs will be interpreted in a manner that balances investment protection with India's regulatory power will depend on arbitral discretion due to the vagueness, broadness and indeterminate nature of the FET provision in Indian IIA.

## CHAPTER 5

### MONETARY TRANSFER PROVISIONS

Monetary Transfer Provisions (MTPs) in IIAs regulate the transfer of funds related to investment in and out of the host country.<sup>740</sup> MTPs are an integral part of the investment treaty based protection offered to foreign investment by the host state. A typical MTP in IIA identifies the ‘transfer’ or ‘payment’ to which the provision applies and also provides the conditions governing such transfers such as whether the transfer is to be made in foreign currency and whether the transfer can be made promptly.<sup>741</sup> In most IIAs, MTPs cover all ‘transfers’ or ‘payments’ related to investment.<sup>742</sup> Further, depending on the treaty language, MTPs cover both inflows and outflows of funds.<sup>743</sup> These ‘transfers’ include – additional capital to maintain and increase investment; net operating profits including dividends; repayment of any loan including interest; proceeds from sales of their shares, etc.<sup>744</sup>

MTPs are important for foreign investors because they provide the freedom to transfer all funds related to investment for a number of business related needs.<sup>745</sup> For example, a foreign investor may need to bring in additional capital to support her existing investment or might need to repatriate capital back to the home country in order to service debts or to pay dividends or to repatriate proceeds of sale of investment, etc.<sup>746</sup> Lack of freedom to transfer funds related to investment may result in investment not being made in the first place because foreign investors will be deprived of the benefits accruing from the investment (such as repatriating profits) and will also not have the freedom to work their investment (like bringing in additional capital to support the existing investment).<sup>747</sup> Thus, a foreign investor will like to have a broad MTP in an IIA allowing prompt transfer of all funds related to investment in foreign currency with limited or no exceptions to this right.

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<sup>740</sup> See Waibel (2009), 497; Salacuse (2010); Kolo and Walde (2008), 205; UNCTAD (2000); Dolzer and Schreuer (2008); Gallagher (2010); Anderson (2009); Turyn and Aznar (2010), 51-78; Muchlinski (2009), 59-61; Vandevelde (2010), 316-33; Salacuse (2010), 256-71.

<sup>741</sup> Vandevelde (2010), 317.

<sup>742</sup> Id.

<sup>743</sup> Vandevelde (2010), 319.

<sup>744</sup> See Article 7 of the Indian Model IIA.

<sup>745</sup> Dolzer and Schreuer (2008), 191.

<sup>746</sup> Salacuse (2010).

<sup>747</sup> Waibel (2009), 498; Kolo and Walde (2008), at 213-14.

The freedom to transfer funds – in and out of the country – will affect the host country's capital account. Capital account is part of the balance of payments (BoP) account of a country reflecting the net change in asset ownership nationally. The BoP account also has a current account which gives the sum of trade balance, net factor income and net transfer payments.<sup>748</sup> The extent of liberalisation of the capital account of a country depends on the capital controls (restrictions that affect the capital account of a country's BoP) imposed. Lesser the controls on capital flows greater will be capital account liberalisation. When these controls are completely eliminated we have full Capital Account Convertibility (CAC).

Imposing capital controls is widely recognised as an integral part of the monetary sovereignty of a country.<sup>749</sup> Capital controls can be of different types like quantity based, price based or even administrative or regulatory in nature.<sup>750</sup> Quantity based capital controls include – minimum stay requirement (for example a country may require that foreign capital invested should stay in the host country for a minimum period). Such a capital control is aimed at reducing the volatility in capital flows. Price based capital controls include – taxes on capital inflows, which might help in stabilising the exchange rate – a case in point is Brazil's taxes on capital inflows imposed in 2009.<sup>751</sup> Some capital controls like the unremunerated reserve requirement (URR) falls both under price and quantity capital control.<sup>752</sup> One can also have regulatory capital controls such as prohibiting certain kind of foreign investments or not allowing investments in certain sectors or in certain assets.

MTPs, *per se*, do not prohibit the imposition of capital controls. However, the extent to which a host country will be able to impose capital controls on capital account transactions will depend on how the MTP in the IIA has been formulated.<sup>753</sup> MTP formulation that allows for prompt transfer of all funds without recognising any exception to this right to transfer, will pose problems in imposition of capital controls by the host state. In other words, if the provision on monetary transfer does not recognise exceptions to transfer of capital, then a capital control measure adopted by the host state can be challenged by the foreign investor in

<sup>748</sup> Krugman and Obstfeld (8<sup>th</sup> edition).

<sup>749</sup> Lastra (2006), 22; Qureshi and Ziegler (2011), 147.

<sup>750</sup> Gallagher (2010); Rangarajan (2000), 4424.

<sup>751</sup> 'Brazil fights Capital Inflows', Deutsche Bank Research available at [http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD000000000251631.pdf](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000251631.pdf).

<sup>752</sup> Gallagher (2010), 4. URR is a type of capital control requiring a certain percentage of short term capital inflow to be kept in deposit in local currency for a certain period of time and hence it has the characteristic of both price and quantity based control.

<sup>753</sup> See Waibel (2009), 498-99; Kolo and Walde (2008), 214; Gallagher (2011), 9.

ITA as a violation of the MTP. 250 economists, from around the world, in their letter to the US Secretary of State, the treasury secretary and the US trade representative have drawn their attention to this problem by focusing on America's trade and investment treaties that restrict the ability of America's trade partners to impose capital controls.<sup>754</sup> The letter said "*the 'capital transfers' provisions of such agreements require governments to permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory*".<sup>755</sup>

In this light, the chapter will study MTPs in 73 Indian IIAs to find out whether they can be interpreted in a manner that is supportive of India's regulatory power to adopt capital controls to meet different policy objectives without breaching the IIA? In order to fully appreciate the relationship between MTPs and India's regulatory power to impose capital controls, this chapter will start by focusing on the significance of capital controls and the merits and demerits of Capital Account Convertibility (CAC) in the global and Indian context (Section 5.1). Section 5.2 will study the anatomy of MTPs in Indian IIAs discussing their salient features and the differences that exist in their formulation. Section 5.3 will focus on two types of MTPs occurring in Indian IIAs – 'free-transfer' type and 'regulatory-transfer' type and will analyse their implications on India's regulatory power.

## 5.1 GLOBAL DEBATE ON CAC

Whether unrestricted and free mobility of capital is good for countries or whether countries should regulate capital flows are moot questions on which economic opinion is divided. The

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<sup>754</sup> 'Economists Urge US to Rethink Capital-Control Restrictions' available at <http://blogs.wsj.com/economics/2011/01/31/economists-urge-us-to-rethink-capital-control-restrictions/>. Also see the open letter written by more than 100 economists on 28 February 2012 to the trade ministers of nine countries (USA, Australia, Brunei Darussalam, Malaysia, New Zealand, Peru, Singapore, Chile and Vietnam) to consider having provisions for imposition of capital controls in the Trans-Pacific Partnership Agreement available at [http://www.ase.tufts.edu/gdae/policy\\_research/TPPAletter.html#statement](http://www.ase.tufts.edu/gdae/policy_research/TPPAletter.html#statement).

<sup>755</sup> Id. Also see the open letter written by more than 100 economists on 28 February 2012 to the trade ministers of nine countries (USA, Australia, Brunei Darussalam, Malaysia, New Zealand, Peru, Singapore, Chile and Vietnam) to consider having provisions for imposition of capital controls in the Trans-Pacific Partnership Agreement available at [http://www.ase.tufts.edu/gdae/policy\\_research/TPPAletter.html#statement](http://www.ase.tufts.edu/gdae/policy_research/TPPAletter.html#statement). It is also important to note that there are many causes of massive and sudden inflow and outflow of capital. Activities of foreign investors, though important, constitute one of the many factors. Capital inflows and outflows also take place when citizens of the host country transfer money abroad or domestic companies raise money in the international market – also called external commercial borrowings or domestic companies invest abroad, etc. In other words, those capital controls that do not affect the activities of foreign investors will fall outside the purview of the IIA.

global financial crisis of 2008<sup>756</sup> has further intensified the debate on this issue.<sup>757</sup> On the one hand, some economists like Stanley Fischer of the IMF have argued that free capital movement will facilitate an efficient global allocation of savings and channelise resources into their most productive uses<sup>758</sup> – such as ensuring the flow of capital from developed countries (where the return to capital is less) to capital-scarce developing countries (where the return to capital is high), which in turn, will result in reducing the cost of capital in developing countries and result in more investment and growth.<sup>759</sup> On the other hand, free or unrestricted capital movement, in a country, can increase economic volatility due to large and sudden capital inflows and outflows.<sup>760</sup> Large infusions of capital can have adverse macroeconomic consequences like appreciation of the country's currency and hence reducing export competitiveness and widening the current account deficit; it can also result in inflation by increasing the money supply, which, in turn can have other adverse macroeconomic consequences.<sup>761</sup> Similarly, large and sudden outflow of capital can have a run on the foreign exchange reserves of the country resulting in depreciation of the currency and adversely affecting the country's ability to meet its international financial obligations (such as financing its imports).<sup>762</sup> It is for these reasons that noted economists like Dani Rodrik,<sup>763</sup> Jagdish Bhagwati<sup>764</sup> and Joseph Stiglitz<sup>765</sup> have questioned the benefits of capital account liberalisation. Rodrik has argued, on the basis of a sample of 100 countries (for the period 1973-1996) that there is no evidence to show that countries without capital controls have grown faster or invested more or have experienced lower inflation.<sup>766</sup> Referring to the East Asian currency crisis, Bhagwati argues, how loosening of the capital account controls by these countries resulted in these countries getting excessively burdened by short term debt capital, which eventually lowered the growth rate of these countries drastically.<sup>767</sup> Stiglitz has

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<sup>756</sup> This crisis started as a sub-prime mortgage crisis in the USA and then snowballed into a global financial crisis affecting not just developed but also developing countries for a detailed analysis of the crisis see – Islam and Nallari (2010); Jones, Ocampo and Stiglitz (2008). According to economic historians this is not the first time that a financial crisis has occurred since the 17<sup>th</sup> century; the world has witnessed 10 major financial crises Kindelberger and Aliber (2005), 8.

<sup>757</sup> Arestis and Singh (2010), 225-38; Frenkel and Rapetti (2009), 685; Ocampo, Spiegel and Stiglitz (2008).

<sup>758</sup> Fisher (1998), 2.

<sup>759</sup> Id. Also see Fischer (2003), 1; Rogoff (1999), 21; Summers (2000), 1.

<sup>760</sup> Ocampo and Palma (2008), 170.

<sup>761</sup> Salacuse (2010), 256.

<sup>762</sup> Id.

<sup>763</sup> Rodrik (1998), 55-65.

<sup>764</sup> Bhagwati (1998), 7-12.

<sup>765</sup> Stiglitz (1999), 1508-1521; Stiglitz (2000), 1075-1086; Stiglitz (2002); Stiglitz (2008), 76-90.

<sup>766</sup> Rodrik (1998), 62. In this regard also see – Prasad *et al* (2003) - which shows that liberalisation of capital markets in developing countries is not connected with economic growth.

<sup>767</sup> Bhagwati (1998), 8.



been a very strong critic of capital market liberalisation and has argued in several of his writings that capital market liberalisation has resulted in more economic insecurity and not economic growth.<sup>768</sup>

The world has witnessed many currency crises in the last two decades or so, like the East Asian crisis in 1997;<sup>769</sup> the Mexican crisis in 1994;<sup>770</sup> crisis in Latin America, over the last two decades, due to surges of capital outflows and inflows;<sup>771</sup> and the global financial crisis of 2008,<sup>772</sup> with mass inflows and outflows of capital across borders,<sup>773</sup> “*which has changed the focus from liberalisation to the regulation of capital liberalisation*”.<sup>774</sup> Many countries have successfully adopted capital controls, as a policy tool, to regulate the inflow or outflow of capital as per their policy priorities. For example, Chile adopted URR to stem the short term volatile inflow of capital and was successful in altering the composition of the capital inflow to medium and long term capital inflows.<sup>775</sup> In 2007, Colombia’s capital controls helped it to mitigate some of the adverse effect of the global financial crisis.<sup>776</sup> It has also been stated that countries that adopted capital controls in years leading to the financial crisis of 2008 were among the least hard hit by the financial crisis.<sup>777</sup> Further, an IMF study shows that certain situations may warrant imposition of capital controls and thus, such controls are an important tool in a country’s policy arsenal.<sup>778</sup>

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<sup>768</sup> Stiglitz (2008), 76-77. In this regard also see – Henry (2007).

<sup>769</sup> Five countries in East Asia - South Korea, Thailand, Malaysia, Indonesia and Philippines – faced a financial crisis in 1997 when there was a turnaround of \$ 86 billion of capital flows from a net inflow of \$ 66 billion in 1996 to a net outflow of \$ 20 billion in 1997. This volatility in capital flows resulted in depreciation of the currencies of these countries against the US dollar and combined with other factors resulted in drastically reducing the growth rate of these countries. For more on the crisis see – Rangrajan (2000), 4421; Kawai, Newfarmer and Schmukler (2001).

<sup>770</sup> The Mexican crisis occurred, *inter alia*, due to reversal of portfolio flows from a peak inflow of \$ 20 billion in 1993 to net outflow of \$ 15 billion in 1995 - Rangrajan (2000), 4423. For a detailed analysis of the Mexican crisis see – Gil-Diaz (1997). Also see Lowenfeld (1988), 1061; Lowenfeld (2008), 688-94.

<sup>771</sup> Ocampo and Palma (2008).

<sup>772</sup> This crisis started as a sub-prime mortgage crisis in the USA and then snowballed into a global financial crisis affecting not just developed but also developing countries. For a detailed analysis of the crisis see – Islam and Nallari (2010); Jones, Ocampo and Stiglitz (eds).

<sup>773</sup> Gallagher (2011), 9.

<sup>774</sup> Qureshi and Zeigler (2011), 217. Also see Hagan (2010), 955.

<sup>775</sup> Le Fort and Lehmann (2003), 50.

<sup>776</sup> Coelho and Gallagher (2010).

<sup>777</sup> Ostry *et al* (2011). Recently, Brazilian President, Dilma Rousseff, rebuked industrialised countries for creating a “liquidity tsunami” of speculative capital, which is being tackled by Brazil by extending the tax on speculative inflows of capital in Brazil – See Gallagher (2012).

<sup>778</sup> Ostry *et al* (2010). For a discussion on this note see – Chandrashekar (2010), 10-11; Subramaniam (2010), 15-17. Also see ‘IMF Backs Capital Controls in Brazil, India’ available at <http://www.deccanherald.com/content/127011/imf-backs-capital-controls-brazil.html>. Other successful examples of capital controls on inflows are in Malaysia (in 1994); Colombia (in 1993) and Thailand - Magub and Reinhart (2006); IMF (2010). It has also been argued that the economic literature supports capital controls

The IMF Articles even allow its member countries to impose restrictions on their capital account transactions. Article VI.3 of these Articles provides that member countries may impose controls as are necessary to regulate international capital movement.<sup>779</sup> However, the member countries while exercising control on international capital movement have to ensure that these controls are not exercised in a manner that will restrict payments on current account since IMF Articles prohibit such restrictions. Article VIII.2 of the IMF Articles provides that subject to certain provisions<sup>780</sup> no member country shall impose restrictions on the payment of transfers for current international transactions.<sup>781</sup> If a member country has to impose restrictions on current account restrictions, then it will have to take the permission of the IMF.<sup>782</sup> An attempt was made in 1997 to amend the Fund articles so as to outlaw imposition of controls on capital account transactions.<sup>783</sup> The purpose was to extend the jurisdiction of the IMF to capital account.<sup>784</sup> However, this proposal was abandoned<sup>785</sup> due to lack of political consensus.<sup>786</sup>

### 5.1.1 Debate on CAC in India

The debate on CAC and whether India should exercise capital controls started with the adoption of liberalised economic policies in early 1990s. India's approach to opening of capital account has been very cautious and gradual especially because of the BoP crisis that India faced in 1990-91.<sup>787</sup> India has used different forms of capital controls like regulatory controls, which are used, for example, to keep foreign investments out of certain sectors like multi-brand retail. It has been argued that this cautious approach and India's capital controls

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on inflows whereas the evidence of benefits on capital control on outflows is inconclusive - Magub and Reinhart (2006); Gallagher (2010).

<sup>779</sup> Lowenfeld (2008), 608.

<sup>780</sup> These provisions are – Article VIII 3(b) and Article XIV.2 of the IMF Articles. Also important to note that once a country notifies to the IMF its willingness to accept the obligations contained in Article VIII, there is no going back – Lowenfeld (2008), 607.

<sup>781</sup> A majority of membership of IMF is now under Article VIII regime – see Qureshi and Ziegler (2011), 205. For a detailed analysis of the IMF Articles and capital and current account transactions see – Gold (1971); Edwards (1985); Qureshi and Ziegler (2011), 202-25; Lowenfeld (2008), 606-22.

<sup>782</sup> Article VIII 2 of the IMF Articles.

<sup>783</sup> Fischer (1997), 9.

<sup>784</sup> Id.

<sup>785</sup> Qureshi and Ziegler (2011), 217 where it is argued that IMF encouraged capital liberalisation but there is no evidence to support the claim that IMF required capital liberalisation *per se*. Also see IMF (2005).

<sup>786</sup> Waibel (2009), 501. In this regard also see Holder (1998), 407.

<sup>787</sup> Rangarajan (2000), 4425.

played an important role in avoiding contagion of the East Asian crisis spreading to India.<sup>788</sup> Economists in India have been debating merits and demerits of capital controls and CAC.<sup>789</sup>

In 1997, a committee was constituted by India's central bank – Reserve Bank of India (RBI) (the Tarapore committee – hereinafter called Tarapore I<sup>790</sup>) to look at the possibility of fuller CAC in India.<sup>791</sup> This committee recommended movement towards CAC in a phased manner provided there was fiscal consolidation, a mandated inflation target and strengthening of the financial system.<sup>792</sup> However, this report was followed by the East Asian currency crisis and as a result movement towards full CAC was put on the back burner. In 2006, another committee was constituted to study CAC, under the leadership of SS Tarapore (same person who headed the first committee also called Tarapore committee – hereinafter Tarapore II). This committee also recommended that movement towards fuller CAC will require a better management of the liquidity risk, strengthening of the banking system and also fiscal consolidation.<sup>793</sup>

Although, over the years, India has certainly opened its capital account, it still imposes different capital controls. Furthermore, since India does not follow a pre-entry approach in its IIAs any restriction such as outright prohibition on capital inflow like in multi-brand retail is compatible with India's IIA obligations. The financial crisis of 2008 calls for a cautious approach towards capital accounts liberalisation.<sup>794</sup> IMF's India Sustainability Report of 2011 very categorically states that *'the full removal of capital controls must, however, be mindful of the risks involved, including a possible increase in domestic interest rates (if Indian financial intermediaries decide to move assets abroad), as well as higher volatility of interest rates which could be damaging for growth. Furthermore, as capital controls strengthened*

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<sup>788</sup> Joshi (2001), 317.

<sup>789</sup> Sen (2007), 292; Prasad (2009); Barua (2006), 1875; Mecklai and Chandrasekhar (2006), 1878.

<sup>790</sup> This committee was headed by SS Tarapore and hence is called the Tarapore committee.

<sup>791</sup> Report of the Committee on Capital Account Convertibility (1997) available at <http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/14029.pdf>.

<sup>792</sup> Id.

<sup>793</sup> Tarapore Committee Report (2007) available at <http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/72250.pdf>. Apart from this there have been two more committees in India that have discussed the issues of CAC - Report of Committee on Financial Sector Reforms (2007), *A Hundred Small Steps*, Planning Commission, New Delhi; and Report of High Powered Committee on Making Mumbai as International Financial Centre (2007), Ministry of Finance, New Delhi. Both these committees have argued in favour of CAC. According to these committees unrestricted capital flow will unleash strong competitive forces and bring other benefits – for more on this see – Patil (2010), 49.

<sup>794</sup> It has been pointed out that India's controls on outflows as well as inflows, in wake of the global financial crisis of 2008, contributed to tide the slump – see Epstein (2012), 52.

*India's resilience to potentially destabilizing outflows during the recent crisis, authorities must retain sufficient flexibility to put them in place if circumstances dictate doing so.'*<sup>795</sup>

India's sovereign right to impose controls on capital account for different policy priorities is consistent with India's obligations under Article VI(3) of the IMF Articles.<sup>796</sup> This sovereign right to impose restrictions on capital account transactions has been codified in the Indian law on foreign exchange called the Foreign Exchange Management Act (FEMA Act) enacted in 1999. According to the preamble of the FEMA Act, the purpose of this legislation is - '*an Act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India*'. Section 5 of FEMA Act talks of current account transactions. It states that '*any person may sell or draw foreign exchange ... if such sale or drawl is current account transaction*'. Current account transaction is defined in Section 2(j) of the FEMA Act - as a transaction other than a capital account transaction. Apart from this general definition, Section 2(j) also gives an illustrative list of current account transactions:

- i. payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,*
- ii. payments due as interest on loans and as net income from investments,*
- iii. remittances for living expenses of parents, spouse and children residing abroad, and*
- iv. expenses in connection with foreign travel, education and medical care of parents, spouse and children.*

Section 5 also allows for imposition of reasonable restrictions for current account transactions in public interest. Section 6 of the FEMA Act talks of capital account transactions. Capital account transaction is defined in Section 2(e) of the FEMA Act as '*a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in*

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<sup>795</sup> IMF (2011). In this regard also see an interesting study on interventions made by the RBI to overcome the volatility caused by FII inflows in India – Behra, Narasimhan and Murty (2008), 69. Kohli (2011).

<sup>796</sup> India cannot impose restrictions on current account transactions after it became an Article VIII member country in 1994 - IMF (2011), IMF Country Report No 11/50 available at <http://www.imf.org/external/pubs/ft/scr/2011/cr1150.pdf>

*India or assets or liabilities in India of persons resident outside India...*’ The Tarapore I committee defined it as ‘*freedom of currency conversion in relation to capital transactions in terms of inflows and outflows*’.<sup>797</sup> When this freedom is absolute, it will be a case of full CAC.

Section 6(1) allows for capital account transactions; however, this is subject to section 6(2), which gives the power to RBI to specify, in consultation with the central government – any class or classes of capital account transactions which are permissible<sup>798</sup> and the limit up to which foreign exchange shall be admissible for such transactions.<sup>799</sup> Also, section 6(3) gives power to the RBI to prohibit, restrict or regulate a number of capital account transactions.<sup>800</sup> Thus, in other words, the capital account transactions are not free and are subject to a number of regulatory controls. The central bank of India has the power to impose restrictions or adopt capital controls to regulate capital account transactions.

However, a twist in India’s tale on CAC and capital controls is provided by the obligations that India has undertaken in its IIAs. The chapter now discusses these issues.

## **5.2 ANATOMY OF MTPs IN INDIAN IIAs**

This chapter has studied 73 Indian IIAs including the Indian model IIA. All the 73 Indian IIAs studied contain MTPs. In other words, transfers of funds related to investment is an integral part of all Indian IIAs.

Article 7 of the Indian model IIA provides:

### *Repatriation of Investment and Returns*

*(1) Each Contracting Party shall permit all funds of an investor of the other Contracting Party related to an investment in its territory to be freely transferred, without unreasonable delay and on a non-discriminatory basis. Such funds may include:*

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<sup>797</sup> Id.

<sup>798</sup> For more on this see Gururaj *et al* (2009).

<sup>799</sup> Section 6(2)(b) of the FEMA Act.

<sup>800</sup> See Section 6(3), (a) to (j) of the FEMA Act.

- (a) Capital and additional capital amounts used to maintain and increase investments;*
- (b) Net operating profits including dividends and interest in proportion to their share-holdings;*
- (c) Repayments of any loan including interest thereon, relating to the investment;*
- (d) Payment of royalties and services fees relating to the investment;*
- (e) Proceeds from sales of their shares;*
- (f) Proceeds received by investors in case of sale or partial sale or liquidation;*
- (g) The earnings of citizens/nationals of one Contracting Party who work in connection with investment in the territory of the other Contracting Party.*

*(2) Nothing in paragraph (1) of this Article shall affect the transfer of any compensation under Article 6 of this Agreement.*

*(3) Unless otherwise agreed to between the parties, currency transfer under paragraph (1) of this Article shall be permitted in the currency of the original investment or any other convertible currency. Such transfer shall be made at the prevailing market rate of exchange on the date of transfer.*

The MTPs in 73 Indian IIAs follow the same structure. They all provide a general obligation that all funds related to investment can be freely transferred followed by a list of transactions that are allowed. Barring a few exceptions, in all IIAs, this list is inclusive. The MTPs in all these 73 Indian IIAs can be divided in two categories on the basis of exceptions to the right of the foreign investor to freely transfer funds. These two types are “free-transfer” and “regulatory-transfer”. The key difference between these two types is that the “free-transfer” MTPs do not contain any exception to the right of the foreign investor to transfer funds whereas “regulatory-transfer” MTPs recognise exceptions to free transfer of capital. 58 IIAs have “free transfer” MTPs whereas 15 IIAs have “regulatory-transfer” MTPs (Table 5.1). Before discussing these two types of MTPs (in Section 5.3), the chapter will discuss other key features that are common to both types of MTPs.

**Table 5.1 - Anatomy of MTPs in 73 Indian IIAs**

Type	Number of IIAs
‘Free-transfer’ type	58
‘Regulatory-transfer’ type	15

*Source – Author’s study of 73 Indian IIAs*

### 5.2.1 Coverage of ‘transfer of funds’

Coverage of ‘transfer of funds’ relates to two things. First, whether the MTP covers only outflow or inflow of funds or both; and second, whether it includes all funds related to investment to be transferred or is it limited to only certain categories of funds related to investment.

#### *Inflows and Outflows*

The title of the MTP in many of these 73 Indian IIAs is ‘*Repatriation of Investments and Returns*’. This title connotes that the majority of MTPs in Indian IIAs include only outflow of funds and not inflows. However, the text of MTPs in these IIAs contain the following words ‘*all funds of an investor of the other Contracting Party related to an investment in its territory to be freely transferred, without unreasonable delay and on a non-discriminatory basis*’. Giving ordinary meaning to these words as per Article 31(1) of the VCLT, one can say that the provision covers both inflows and outflows of funds because of the use of the words ‘all funds’ and not just ‘funds’ related to investment. Further confirmation of this point comes from the following specific transaction provided in the provision on monetary transfer – ‘*capital and additional capital amounts used to maintain and increase investments*’- which means that the investor is allowed to bring in additional capital to maintain his existing investment.<sup>801</sup> In this regard, it is important to note that Article 94 of the India-Japan IIA, titled transfers, specifically states that all transfers can be freely made ‘*into and out of its area*’ thus expressly stating that the MTP covers both inflows and outflows.

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<sup>801</sup> In this regard also see Vandeveld (2009), 319.

### *All transfer of funds*

The next issue in ‘coverage of transfers’ is whether MTPs in Indian IIAs cover all kinds of transfers (in and out of the country) or is it limited to specific types of transfers. Out of the 73 Indian IIAs studied, in 70 IIAs, after mentioning that all funds can be transferred, an illustrative list of the transfer of funds is provided. This list in these 70 IIAs is inclusive meaning thereby that the list is open ended or non exhaustive (see Table 5.2). In other words, since the list is illustrative, other transfer of funds, not mentioned in the list, are also included. The only limitation recognised is that the transfer of funds should be related to an investment. Any transfer of funds that is ‘not’ related to investment is outside the scope of the MTP.<sup>802</sup>

However, in 3 Indian IIAs [India-Denmark – Article 7 (1), India-Italy – Article 7 (1), India-Belgium – Article 7 (1)], the list of transfer of funds is exhaustive. In these 3 IIAs, the word ‘includes’ is not present and hence the argument that the list is exhaustive or closed. For example, Article 7(1) of India-Denmark IIA states that ‘*Each Contracting Party shall with respect to investments in territory by investors of the other Contracting Party allow the free transfer of*’. This is then followed by a list of funds that can be transferred. Since the treaty does not mention words like ‘include’ or ‘may include’ arguably a Danish investor from India can transfer only those funds related to investment that are enumerated in the treaty and not transfer any other funds related to investment.

**Table 5.2 – Coverage of Transfer of funds related to investment in Indian IIAs**

Non Exhaustive coverage of transfer of funds	Exhaustive coverage of transfer of funds
70 IIAs	3 IIAs

*Source – Author’s study of 73 Indian IIAs*

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<sup>802</sup> For example, in *Continental Casualty v Argentina*, ICSID Case No. ARB/03/9 the tribunal held that a transfer that is not ‘related to investment’ was outside the scope of Article V of the US-Argentina IIA. Article V of the US-Argentina IIA, like Article 7 of the India model IIA, is broad and covers all transfers related to investments - *Continental tribunal*, paras 238-42.



### 5.2.2 Unreasonable Delay

Out of the 73 Indian IIAs studied, 66 of them provide for a transfer of capital without delay (See Table 5.3). Only two Indian IIAs – India-Belgium - Article 7 (1) and India-Argentina – Article 7 (1) are silent on whether the funds can be transferred without delay or not. Out of the 66 IIAs, that allow transfer of funds without delay, 62 of them provide that foreign investors are allowed to transfer funds without unreasonable delay – thus, further qualifying the delay requirement. In other words, these MTPs allow for a reasonable delay in transfer of capital. However, none of these IIAs, barring five of them, provide any indication as to how to find out whether a delay is unreasonable or reasonable. In five IIAs – [India-Denmark - Article 7 (1); India-Germany – Article 7 (1); India-Spain – Article 8 (1); India-Austria – Article 6 (1); and India-Saudi Arabia – Article 6], there is a reference to the time duration. In these five IIAs, if the delay is for more than the stipulated time allowed, then the delay will become unreasonable. The time period in these IIAs varies from one to three months from the date when the request for transfer is made.

**Table 5.3 – Delay requirement in allowing transfer of funds in Indian IIAs**

Unreasonable delay requirement	Delay requirement	‘delay requirement’ not mentioned	Unreasonable delay requirement in terms of time duration
62 IIAs	4 IIAs	2 IIAs	5 IIAs

*Source: Author’s survey of 73 Indian IIAs.*

### 5.2.3 Currency of Transfer

One of the important issues that will arise each time the foreign investor wishes to transfer capital is in which currency can the foreign investor make the transfer? More specifically, if the foreign investor wishes to repatriate capital back to her home country, then the question will be whether the host country allows her to convert capital into a foreign currency that is accepted at the international level or not. If, the host country does not let the investor undertake this conversion (for example by stopping her from buying foreign currency), then it

will frustrate the very purpose of having a MTP in the IIA. On the other hand, in certain situations such as in the event of an external payment crisis or in situations of BoP difficulty, the freedom to choose any currency for transfer could have an adverse macroeconomic impact on India. For example, in case of an external financial difficulty, India will like to avoid a run on its foreign reserves held in US dollars. Thus, in such a situation, India might face difficulty if US dollar is chosen as the currency of transfer by the foreign investor.

**Table 5.4 – Currency of transfer in Indian IIAs**

<b>Currency transfer type</b>	<b>Number of IIAs having this particular formulation</b>
transfers in the original currency in which the investment was made or any other ‘convertible currency’ (same as model IIA)	38
Transfers in currency of original investment or ‘freely convertible currency’	7
Transfers in freely convertible currency	16
Transfers in convertible currency	9
No mention about currency transfer	3

*Source: Author’s survey of 73 Indian IIAs.*

As evident from Table 5.4, Indian IIAs have different formulations for currency transfer. 37 IIAs follow the formulation that exists in the Indian model IIA, *i.e.*, transfer in the original currency in which the investment was made or in any convertible currency. However, in this category, there is one IIA (India-Belarus – Article 7.2) which states that any other convertible currency has to be agreed to between the investor and the contracting party. A provision like this gives some flexibility to India in regard to the currency of payment by providing India the possibility of negotiating with the investor from Belarus as to the specific convertible currency.<sup>803</sup> However, barring such a provision, the foreign investor will be able to make transfer in currency of her choice – either the currency of investment or any other convertible currency. Some Indian IIAs provide for transfer in either freely convertible currency or a

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<sup>803</sup> Salacuse (2010), 264.

convertible currency but do not contain the option of making a transfer in the currency in which the investment was made.

Few Indian IIAs give the meaning of “freely convertible currency”. For example, Article 1(b) of the India-Australia IIA state - “*‘freely convertible currency’ means a convertible currency as classified by the International Monetary Fund or any currency that is widely traded in international foreign exchange markets*”. Thus, this IIA provides for using the IMF definition for ‘freely convertible currency’. IMF Articles provide a definition of a “freely useable currency” in Article XXX(f). According to this Article a *‘freely useable currency means a member’s currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets’*. IMF’s Executive board has identified four currencies that meet this standard – US dollar, Japanese Yen, British pound and Euro.<sup>804</sup> For those Indian IIAs that do not define ‘freely convertible currency’, one can have recourse to Article XXX(f) of the IMF Articles by relying on Article 31(3)(c) of the VCLT, for those countries who are also members of the IMF. However, there is an interesting point worth noting in this debate. Since Article XXX(f) of the IMF Articles gives the definition of “freely convertible currency” and not “convertible currency”, arguably, the phrase “convertible currency” cannot be limited to just the four currencies mentioned above. Since many Indian IIAs talk of any “convertible currency” and not of “freely convertible currency”, under these IIAs, India allowing for conversion in any other currency outside the four currencies mentioned above, will be consistent with India’s MTPs. Thus, for these Indian IIAs, even Australian dollar or Singapore dollar can be a convertible currency.

There are three Indian IIAs that do not mention anything on currency of transfer. These three IIAs are – India-France (Article 7); India-Belgium (Article 7 (1)); and India-Saudi Arabia (Article 6).

Thus, on these three issues – coverage of funds that can be transferred, currency in which it can be transferred, and how quickly the transfer can be made – there is a high degree of homogeneity amongst the MTPs in Indian IIAs. Almost all of the Indian IIAs allow for a wide range funds to be transferred in a convertible currency and without much delay.

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<sup>804</sup> UNCTAD (2000), 33.

Furthermore, almost all Indian IIAs allow the transfers at the prevailing market rate of exchange. Therefore, a plain reading of these IIAs certainly restrict India's regulatory power to impose capital controls on foreign investments or in other words, given this broad nature of the MTPs, India cannot impose capital controls without violating the MTPs in its IIAs.

In spite of containing all these broad investor friendly components, the host country's regulatory power to impose restrictions on capital transfers can be preserved, if the MTPs contain certain exceptions such as allowing the host country to impose restrictions on capital transfers in the event of an external financial difficulty or for any monetary objective such as currency stabilisation, maintaining foreign reserves, etc. We now turn to the issue of exceptions in MTPs in Indian IIAs.

### **5.3 MTPs IN INDIAN IIAs AND CAPITAL CONTROLS**

Whether a MTP in an IIA recognises the regulatory power of India to impose capital controls depends on its formulation. A MTP in an IIA can have three types of exceptions to preserve host country's regulatory power to adopt capital controls or other restrictions on capital transfers for different policy objectives. First, it could contain an exception that allows the host country to restrict transfers in cases of bankruptcy or insolvency, or in cases of criminal or penal offences or in cases of ensuring compliance with adjudicatory proceedings.<sup>805</sup> All these exceptions are aimed at enabling host countries achieve different types of regulatory interests. These exceptions are not related at achieving monetary objectives. Thus, we can call these exceptions as "non-monetary" exceptions in MTPs.

Second, MTPs can also contain exceptions whose main role is to enable the host country to exercise regulatory power in achieving monetary objectives. Thus, a MTP can have an

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<sup>805</sup> For example, Article 94 (3) of the India-Japan IIA provides exceptions to the right of foreign investors to transfer funds in the following terms – '*Notwithstanding paragraphs 1 and 2, a Party may delay or prevent such transfers through the equitable, non-discriminatory and good faith application of its laws relating to:*

*(a) bankruptcy, insolvency or the protection of the rights of creditors;*

*(b) issuing, trading or dealing in securities or derivatives including futures and options;*

*(c) criminal or penal offenses;*

*(d) ensuring compliance with orders or judgments in judicial proceedings or administrative rulings; or*

*(e) obligations of investors arising from social security, and public retirement or compulsory savings scheme'.*

exception that allows host country to impose restrictions on capital transfers for BoP purposes and other macroeconomic objectives like maintaining a stable currency, healthy foreign exchange reserve. These objectives may either be mentioned separately in the IIA or the IIA may be subject to the IMF Articles. For example, Article 10.8 (4) of India-Malaysia IIA after recognising the right of the foreign investors to transfer funds provides the following – ‘*Nothing in this Chapter shall be regarded as altering the rights enjoyed and obligations undertaken by a Party as a party to the Articles of Agreement of the International Monetary Fund, as may be amended*’. This type of exceptions can be called ‘monetary exceptions’.

Third, MTPs can also contain exceptions by subjecting the entire MTP to the domestic laws of the host country. Such an exception will enable the host countries to exercise regulatory power for any policy objective and arguably will give a far greater regulatory power as compared to the first two exceptions. This is because an exception of this nature will allow the host country to impose restrictions on transfer of payments for any policy objective and not just those given in the IIA. For example, an Indian policy requires that investments made in developing townships cannot be repatriated for the first three years from completion of minimum capitalisation.<sup>806</sup> Such a policy, even if not mentioned in the IIA, will yet be compatible if the MTPs are made subject to domestic laws. However, such an exception can also be misused by the host country, for example by changing the domestic law at will, and thus could tilt the balance in favour of the host country over the foreign investor rather than balancing investment protection with the host country’s regulatory power.<sup>807</sup>

As mentioned above, out of the 73 Indian IIAs studied, 58 of them do not contain any exception of the type discussed above (free-transfer) (See Table 5.5). In 5 IIAs MTPs are subject to domestic laws and in 10 IIAs MTPs recognise specific exceptions to the foreign investor’s rights to transfer funds (regulatory-transfer – Section 5.3.3).

Another important point to note is that there is no one common trend or pattern that can be seen in the MTPs in Indian IIAs. For instance, there are examples where an IIA signed at the same time have different provisions like Article 7 (1) of the India-Italy IIA providing that

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<sup>806</sup> ‘Consolidated FDI Policy’, Department of Industrial Policy and Promotion, Ministry of Commerce available at [http://siadipp.nic.in/policy/fdi\\_circular/fdi\\_circular\\_1\\_2010.pdf](http://siadipp.nic.in/policy/fdi_circular/fdi_circular_1_2010.pdf).

<sup>807</sup> Also see Dolzer and Schreuer (2008), 193.

transfers have to be made “in accordance with domestic laws and regulations”,<sup>808</sup> whereas the monetary transfer provisions in India-UK (Article 7) and India-Poland (Article 7.1) IIAs do not contain any such qualification. India signed an IIA with Singapore, in 2005, which contains provisions that allow for imposing restrictions on transfer of funds in certain exigencies.

**Table 5.5 – Exceptions to MTPs in Indian IIAs**

<b>Nature of Exception to MTPs in Indian IIAs</b>	<b>Number of IIAs having such exception</b>
No exception	58
Exception in the form of “subjecting the MTP to domestic law”	5
Exception in the form of specific exceptions in the treaty	10

*Source: Authors’ survey of 73 Indian IIAs.*

Further, it is also not the case that India has negotiated for exceptions in those IIAs where it is a net capital importing country and does not have exceptions with those IIA countries where it is an exporter. For example, there are no exceptions to free transfer of capital in IIAs with countries like UK (Article 7) and Germany (Article 7), who are capital exporters to India. On the other hand, it has exceptions in IIAs with countries like Iceland (Article 7.4) and Slovakia (Article 6.4), with which foreign investments (both ways) are limited. IIAs containing both, “free-transfer” MTPs and “regulatory-transfer” MTPs have been signed at the same time. Thus, in other words, there is no one trend or pattern that can be noted about the structure of MTPs in Indian IIAs.

Let us understand the implications of both these types of IIAs on India’s regulatory power.

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<sup>808</sup> See Article 7(1) of India-Italy IIA.

### 5.3.1 'Free-transfer' type

MTPs in 58 Indian IIAs neither subjects capital transfers to domestic laws and regulations; nor contains any “monetary” or “non-monetary” exceptions. Thus, the “free-transfer” MTPs give an absolute right to the foreign investor to transfer funds related to investment. While this is certainly advantageous for the foreign investors because it gives them maximum freedom to transfer funds related to investment; it will not serve India’s interests as a host nation. Adoption of capital controls by India on those transfer of funds related to investment that fall under these 58 IIAs can be challenged by foreign investors in ITA<sup>809</sup> even if such capital controls have been duly adopted under the FEMA Act.<sup>810</sup> Important to note that the “free-transfer” MTPs do not prohibit India from adopting capital controls. However, if such controls are adopted, the “free-transfer” MTPs are capable of interpretation where investor’s right to transfer funds will get precedence over India’s regulatory power to impose capital controls because these 58 “free-transfer” MTPs do not recognise any exception to the investor’s right to transfer funds.

Arguably, India can impose restrictions on transfer of funds, even if MTPs allow for free transfer, by relying on other international treaties like the General Agreement on Trade in Services (GATS)<sup>811</sup> and IMF.<sup>812</sup> IMF Articles establish an international monetary order, whose effectiveness hinges on countries not departing from its foundational element. Thus, in the interest of the stability of this order, arguably, India can impose restrictions on transfer of funds in the ‘free transfer’ MTPs even if they do not explicitly recognise imposing such restrictions.

In order to understand whether India can do so, let us look at how an arbitral tribunal interpreted a similar MTP in US-Argentina IIA.<sup>813</sup> In *Continental Casualty v Argentina*,

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<sup>809</sup> For a discussion on what sorts of IIA violations can take place by imposing restrictions on repatriation of funds related to investments see Kolo and Walde (2008), 227-36.

<sup>810</sup> The issue of compatibility between MTPs in IIAs (pre accession BITs) and other regulations (EU Treaty or the EC law) has also arisen in EU – see – *Commission of EU v Republic of Austria*, Case C - 205/06 available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0205:EN:HTML> (as on 2 October 2010); *Commission of EU v Kingdom of Spain*, Case C - 249/06 available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0249:EN:HTML> (as on 2 October 2010).

<sup>811</sup> Article XII of GATS allows countries to impose restriction on trade in services in the event of serious BOP problems or external financial difficulties.

<sup>812</sup> Turyn and Aznar (2010), 72.

<sup>813</sup> Article 5 (1) of the US-Argentina provides ‘Each Party shall permit all transfers related to an investment to be made freely and without delay into and out of its territory. Such transfers include: (a) returns; (b) compensation pursuant to Article IV; (c) payments arising out of an investment dispute; (d) payments made

Argentina argued that notwithstanding the absence of any exceptions in the MTP in US-Argentina IIA, it could impose restrictions on capital transfer due to two facts – first, international treaties like GATT, GATS and IMF allow for such imposition; and second, under customary international law countries have the right to regulate monetary transfers as part of monetary sovereignty of states.<sup>814</sup> Although the tribunal did not decide on this issue since it had already found that the concerned transfer didn't fall in the purview of the MTP (Article V) because it was not a transfer related to investment; it did make an important point by saying that the MTP in the US-Argentina IIA was *lex specialis* in respect of the IMF regime and also more liberal than the IMF regime.<sup>815</sup> The reasoning of the tribunal was that IMF distinguishes between current and capital transactions whereas such a distinction is missing in the MTP in US-Argentina IIA.<sup>816</sup> Although, the tribunal didn't take this analysis further, a logical extension of this will be that in case of a dispute, the tribunal will rely on the MTP to find out whether any restriction on capital and current account transactions is permitted. In other words, if a MTP does not allow a restriction on capital transfer of funds related to investment, restrictions will be held as a breach of the MTP.

An argument that India can impose restrictions on transfer of funds even when none exist in the IIA is also not compatible with the basic canons of treaty interpretation. Giving ordinary meaning to the terms used in the “free transfer” MTPs, in light of the context and object and purpose of the treaty shows that the countries didn't intend to have any restriction on transfer of funds related to investment. Had India and its IIA partner country intended to such restrictions, they would have clearly provided such exceptions in the treaty. Further, the object and purpose of majority of Indian IIAs also lends weight to such an interpretation. India agreed not to have restrictions on transfer of funds in majority of its IIAs because it wanted to give assurances to foreign investor that they have all freedom to invest and operate in India, including the right to transfer funds related to investment, with the hope that such an assurance will result in more investment inflows.<sup>817</sup>

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*under a contract, including amortization of principal and accrued interest payments made pursuant to a loan agreement directly related to an investment; (e) proceeds from the sale or liquidation of all or any part of an investment; and (f) additional contributions to capital for the maintenance or development of an investment.'*

<sup>814</sup> Argentina's rejoinder in the *Continental* tribunal, para 297.

<sup>815</sup> *Continental* tribunal, para 244.

<sup>816</sup> *Id.*, paras 243-44.

<sup>817</sup> Interview with an official of the Ministry of External Affairs.



It is doubtful whether the treaty interpreter can borrow the intent of the countries reflected in some other treaty into the primary treaty that has to be interpreted, especially when this very intent is missing from primary treaty. This is not to argue that the treaty interpreter cannot or should not look at other international treaties applicable between the parties – as this is a requirement under Article 31(3) (c) of the VCLT. Indeed, as it has been discussed above, IMF articles can be used to find out the meaning of terms like “freely convertible currency” not defined in a MTP. Even, the *Continental* tribunal relied on Article XXX of the IMF that defines current account transactions to find out whether the transfer in question was a fund related to investment.<sup>818</sup> However, it is disputable whether the treaty interpreter can rely on Article 31(3) (c) to borrow the intent reflected in another treaty into the applicable law, *i.e.*, the IIA. IMF Agreement is about regulating monetary affairs and IIAs are about investment protection. Thus, the context and object and purpose of the two treaties are different. In other words, in cases where the MTPs in IIAs do not mention about the IMF regime, the presumption is that countries wanted to keep the IMF regime outside the IIA.<sup>819</sup>

Furthermore, in the context of India, this argument will be even more difficult because there are 15 IIAs (discussed in the next section) that allow the host country (India) to impose restrictions on capital transfer. Thus, the argument will be that in the treaties where India wanted to have restrictions on transfer of funds, it provided for such exceptions. Therefore, the IIAs where such exceptions were not put, it clearly means that India didn’t intend to have such restrictions against the foreign investors of those countries.

If not IMF articles, arguably India can rely on customary international law to impose restrictions even if such restrictions are not mentioned in the MTPs. For example, India can rely on customary international law defence of necessity given in Article 25 of the ILC Articles to escape liability from a violation of a treaty obligation (like the MTP). However, such a situation will be governed by the strict and limited nature of the necessity defence available in Article 25 of the ILC Articles.<sup>820</sup>

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<sup>818</sup> *Continental* tribunal, para 244.

<sup>819</sup> Muchlinski (2009), 60.

<sup>820</sup> For more on the strict nature of Article 25 of the ILC Articles see the chapter 6 on NPM.

It has also been argued that general international law considers that in the event of serious balance of payments difficulties – countries may establish regulations on capital transfers<sup>821</sup> or more generally that under general international law countries have the power to impose capital controls as part of their monetary sovereignty.<sup>822</sup> However, one is unsure whether an ITA tribunal will accept a defence based on general international law. For example, an ITA tribunal, like the *Continental* tribunal, may decide that the MTP is *lex specialis* and hence should be given effect to over the defence based on general international law. Stated differently, whether India's defence based on general international law will be accepted or not depends on arbitral discretion because Indian IIAs are not specific on this point.

A violation of the MTP and thus a breach of the IIA can be excused if it falls under any exception clause of the IIA such as a Non Precluded Measure (NPM) provision.<sup>823</sup> Majority of NPM provisions in Indian IIAs are defined narrowly and allow deviations from IIA obligations only in cases of essential security interest or in situations of extreme emergency. It is a moot point whether essential security interest can be used to justify imposition of restrictions on transfer of funds related to investment. Even if one were to argue that essential security interest is broad enough to include measures imposed to restrict transfer of funds related to investment in the case of extreme BoP problem; it certainly cannot be used in those situations where an 'essential' 'security interest' is not at stake.<sup>824</sup> For example, India cannot rely on NPM provisions for all kinds of monetary objectives that it might wish to pursue by imposing temporary capital controls like stopping the rupee from appreciating beyond a point in order to remain export competitive.

### 5.3.2 'Regulatory-transfer' type

There are 15 IIAs that contain some sort of qualification for the transfers of funds. Hence, MTPs in these 15 IIAs are described as 'regulatory-transfer' type. The 'regulatory-transfer' MTP formulation is similar to the 'free-transfer' MTP formulation in terms of having same broad provisions that cover all sorts of transfer of funds. However, they differ from the 'free-

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<sup>821</sup> Turyn and Aznar (2010), 74.

<sup>822</sup> See Lastra (2006), 22; Qureshi and Ziegler (2011), 147.

<sup>823</sup> NPM provisions in an IIA means those measures, which a country is not prohibited from taking to achieve certain regulatory objectives, even if it means not honouring substantive obligations of investment protection. On this issue also see Kolo and Walde (2008), 217-26; the NPM chapter.

<sup>824</sup> On this point also see Kolo and Walde (2008), 212.

transfer’ formulations in one important respect – they recognise some exception to the free transfer of funds.

Though, this does not mean that the MTPs in these 15 IIAs have similar formulation. The exception in the MTPs in these ‘regulatory-transfer’ type IIAs are worded differently. The exceptions are of all the three types mentioned above – first, some IIAs state that funds will be repatriated in accordance with domestic laws and policies; second, some IIAs state that India, as a host country, can impose restrictions on the transfers of funds in situations of BoP difficulty (monetary objectives); and third, restrictions can be imposed for other non-monetary objectives. Some IIAs contain both ‘monetary’ and non-monetary’ objectives.

Out of these 15, 5 Indian IIAs subject transfer of funds related to investment, to domestic laws and policies (see Table 5.5) For example, Article 7(1) of the India-Russia IIA states – *‘Each contracting party shall, in accordance with the laws and regulations of its state, ensure to investors of the other contracting party, the free transfer of payment in relation to investments...’*. The other four Indian IIAs are – India-Israel (Article 7.1); India-Italy (Article 7.1); India-Malaysia (Article 10.8.3); and India-Argentina (Article 7.1). In fact, India-Malaysia, subjects the transfers to not just national laws and regulations, but also to national policies.<sup>825</sup> In all these 5 IIAs, transfers of funds related to investments are subject to local laws. These IIAs do not contain provisions that allow for imposition of restrictions on transfers on account of any economic crisis or any other non-monetary objective. They also do not mention anything on compatibility with the obligations under the IMF Articles.

Hence, if India imposes restrictions or regulates or prohibits capital account transactions as per FEMA legislation, such measures will not amount to violations of MTPs. Provisions such as these have two advantages – first, it ensures that domestic measures on transfers are compatible with India’s IIA obligations; and secondly and most importantly it allows exercise of regulatory power related to transfers of funds provided the exercise of this power is compatible with the domestic law on foreign exchange (FEMA).

The other 10 Indian IIAs (India-Slovakia – Article 6.3; India-Iceland – Article 7.4; India-Mexico – Article 8.4; India-Singapore – Articles 6.6.2 and 6.7, India-Korea – Articles 10.10

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<sup>825</sup> Article 6(1) of the India-Malaysia IIA.

and 10.11, India-Japan – Article 94.3, India-Malaysia – 10.8.3, India-Bulgaria – Ad Article 7.4, India-Romania - Ad Article 7.4, and India-Czech Republic – Ad Article 2) contain express exceptions to MTPs. For example, Article 6(3) of the India-Slovakia IIA states *‘notwithstanding paragraphs 1 and 2 above, a contracting party may prevent or restrict transfer through non equitable, non-discriminatory and good faith application of its laws...’*. The India-Slovakia IIA then provides that this restriction could be for adoption of safeguard measures in circumstances such as macroeconomic or serious BoP difficulties. These restrictions are to be imposed for a limited duration and may not go beyond what is necessary to remedy the BoP situation.<sup>826</sup> This IIA also allows the host country to impose restrictions on capital transfer for non-monetary policy objectives like protection of rights of creditors, criminal or penal offences and the recovery of proceeds of crime. However, this IIA does not mention anything regarding the IMF obligations.

The MTP in India-Iceland IIA is different from India-Slovakia in the sense that it only allows imposition of restrictions on transfers in case of serious BoP difficulty or the threat thereof.<sup>827</sup> It does not recognise situations of macroeconomic difficulty (there could be situations of macroeconomic difficulty different from BoP difficulty like appreciating currency). It also does not recognise other non-monetary objectives like the ones given in India-Slovakia IIA. Like the later this IIA also does not mention anything about the IMF Articles.

On the other hand, the MTPs in the other three IIAs - India-Mexico, India-Singapore and India-Korea, contain both the monetary and non-monetary objectives and also talk of consistency of the measures adopted with the IMF articles. For example, the MTP in India-Mexico IIA allows for preventing a transfer in cases of bankruptcy, insolvency, or the protection of the rights of creditors and similar other situations provided this prevention is applied through equitable, non-discriminatory and good faith application of laws of the country adopting these measures.<sup>828</sup> Apart from this, India-Mexico IIA also allows the host country to adopt restrictions on transfers in cases of serious balance of payments crisis or an external difficulty provided the restriction imposed is consistent with the Articles of the IMF; avoid unnecessary damage to commercial interest of the investor; are no more than necessary to deal with the problem; are temporary and are phased out progressively; are applied on an

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<sup>826</sup> Article 6.4 of the India-Slovakia IIA.

<sup>827</sup> Article 7(4) of the India-Iceland IIA.

<sup>828</sup> See Article 8(3) of India-Mexico IIA.

equitable and non-discriminatory basis; and are promptly notified to the other country.<sup>829</sup> Similar sort of provisions exist in India-Korea and India-Singapore IIA.

Here it is important to mention that India's IIAs with three countries – Bulgaria, Romania, and the Czech Republic have been amended in 2007, 2009 and 2010 respectively. These amendments by all the three countries have been carried out not on the behest of India but on the behest of these three countries in order to comply with their obligations as member states of the EU.<sup>830</sup> One of the key amendments is of the provision on monetary transfer. The MTP in none of these three IIAs recognised any exception to the right of foreign investor to transfer funds. However, after the amendment, all these three IIAs recognise that restrictions can be made on transfer of funds. For example, Article II of the India-Bulgaria protocol adds the following paragraph to Article 7 of their IIA that provides the provision on monetary transfer:

*“(4) Nothing in paragraph (1) of this Article shall prevent either Contracting Party from applying or enforcing, in good faith and in an equitable and non-discriminatory manner, their laws and regulations aiming for:*

- a) issuing, trading or dealing in securities, futures, options, or derivatives;*
- b) adoption of safeguard measures, for a reasonable period of time, which may be taken in exceptional circumstances such as serious macroeconomic difficulties or serious difficulties for the balance of payments for the host Contracting Party or for any customs, economic and monetary union, common market, free trade area or regional economic organization, to which it is or may become a party;*
- c) implementation of any obligation which is binding on that Contracting Party by virtue of its membership to any customs union, economic and monetary union, common market, free trade area or regional economic organization;*
- d) enforcing decisions taken in criminal and adjudicatory proceedings.”*

In other words, the protocol amending the MTP in India-Bulgaria IIA clearly recognises exceptions of both monetary (adoption of safeguard measures at the time of macroeconomic or BoP difficulty) and non-monetary objectives (such as enforcing decisions in criminal and

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<sup>829</sup> See Article 8(4) of India-Mexico IIA.

<sup>830</sup> Protocols amending the IIAs signed between India and the three countries.

adjudicatory proceedings). Similar amendments have been introduced in the IIAs with Romania and the Czech Republic.

Notwithstanding these differences amongst the “regulatory-transfer” MTPs, these few IIAs strengthen India’s regulatory power to adopt measures linked to restrictions on transfers related to investments in cases of an external financial difficulty or for other policy objectives. MTPs, in some of these IIAs harmonise the IIA obligations with the obligations imposed by the IMF Articles and makes Indian domestic law on transfers compatible with IIA obligations.

### ***SUMMARY***

MTP is an important provision that allows foreign investors the freedom to transfer funds, which is integral for them to work their investment in the host country. From the discussions above, one can sum up that MTPs in majority of Indian IIAs provide a broad and unqualified right to foreign investors to transfer funds without recognising any restrictions on this right. Only a handful of Indian IIAs contain provisions on monetary transfer that recognise India’s right to restrict transfer of funds in certain monetary and non-monetary related situations. As a result, adoption of capital controls by India can be challenged as a violation of the provision on monetary transfer by foreign investors in 58 out of 73 Indian IIAs.

## CHAPTER 6

### NON PRECLUDED MEASURES

Non Precluded Measures (NPM) provisions in an IIA (starting with words like – ‘*nothing in this agreement precludes...*’) provide the regulatory latitude to host countries to deal with threats to important national interests.<sup>831</sup> NPM provisions in IIAs provide flexibility to countries to deviate from the substantive obligations in certain circumstances that warrant giving preference to non-investment policy goals over investment protection.<sup>832</sup> Given the larger debate on conflict between investment protection and host country’s regulatory power, NPM provisions in IIAs are useful tools that allow a host country to adopt measures for the pursuance of non-investment objectives without incurring any liability under international law. A measure falling under the NPM provision will be legal, notwithstanding its inconsistency with all other IIA provisions.<sup>833</sup> NPM provisions are important in maintaining a balance between investment protection and regulatory power of the host states much like Article XX of GATT (the general exceptions clause) – which is a key provision to balance free trade with non trade policies.<sup>834</sup> It has also been argued that NPM provisions in IIAs perform a risk allocation function by transferring costs of harming an investment from host states to investors in exceptional circumstances.<sup>835</sup> NPM provisions can also be called by other names like a general exception clause.

NPM provisions in IIAs were put to a test when a spate of arbitration cases were brought against Argentina for adopting measures aimed at addressing an economic crisis in early 2000.<sup>836</sup> For example, US investors claimed that the regulatory measures adopted by Argentina violated many provisions of the US-Argentina IIA; whereas Argentina relied on

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<sup>831</sup> Salacuse (2010), 343. Also see Newcombe (2011), 356-357.

<sup>832</sup> In this paper, the phrase ‘NPM provision’ refers to the provision in the treaty (IIA) whereas use of ‘NPMs’ or ‘NPM’ refers to the measures adopted under the NPM provision.

<sup>833</sup> Vandevelde (2009), 178.

<sup>834</sup> Eeckhout (2010), 8; also see Kapterian (2010), 93-94.

<sup>835</sup> Burke-White and Von Staden (2008), 314. An IIA can also have other kinds of exceptions, which are specific to a particular provision like Indian IIAs exempt taxation measures from the application of Most Favoured Nation (MFN). However, discussion on such provision specific exceptions is outside the purview of this paper.

<sup>836</sup> For more on the Argentine economic crisis and subsequent IIA disputes see – Alvarez and Khamsi (2009).

the NPM provision given in Article XI of the IIA as a defence for these claims.<sup>837</sup> Article XI provides - ‘*This treaty shall not preclude the application by either party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests*’. Although in all these cases it was the same NPM provision that had to be interpreted, the tribunals gave divergent rulings. The *CMS*, *Sempra* and *Enron* tribunals interpreted the NPM provision by reading the customary law necessity defence given in Article 25 of the ILC Articles (hereinafter Article 25)<sup>838</sup> into the treaty defence (NPM). Article 25 is an extremely stringent exception to escape liability from an international wrongful act. Its strict character is confirmed by the commentary on the ILC Draft Articles.<sup>839</sup> On the other hand, *LG&E* and *Continental* tribunals and the *CMS* and *Sempra* annulment committees distinguished between the NPM in the US-Argentina IIA and the Article 25 defence. In yet another divergence in interpreting ‘necessary’ in Article XI of the US-Argentina IIA, recently, the *El Paso* tribunal used one principle of the customary law ‘necessity’ doctrine to interpret ‘necessary’ occurring under the NPM provision by relying on Article 31(3)(c) of the VCLT (see the section on nexus requirement for further discussion on this). All these cases have generated debate on the significance of the NPM provision in IIAs to protect host country’s regulatory power<sup>840</sup> and on the interpretative methodology followed by these tribunals.<sup>841</sup> Further and as it has been discussed throughout the thesis, these cases

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<sup>837</sup> See *CMS Gas Transmission Co v Argentina*, ICISD Case No ARB/01/8; *CMS Gas Transmission Company v Argentina*, ICSID Case No ARB/01/8 (Annulment Proceedings); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3; *Enron Creditors Recovery Corp v Argentina* ICSID Case No ARB/01/3 (Annulment Proceeding); *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16; *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16 (Annulment Proceedings); *LG&E Energy Corporation v Argentina*, ICISD Case No ARB/02/1; *Continental Casualty Company v Argentina*, ICSID Case No ARB/03/9. *El Paso v Argentina*, ICSID Case No. ARB/03/15, 31 October 2011.

<sup>838</sup> Article 25 gives the customary defence of necessity. This defence can be invoked if the adopted measure is the ‘only way’ for the state to safeguard an essential interest against a ‘grave and imminent peril’ [25 (1) (a)]. Furthermore, this defence is subject to three more stringent conditions – firstly, the adopted measure does not impair the essential interest of the other state or of the international community as a whole [25 (1) (b)] secondly, the international obligation in question does not exclude the possibility of invoking necessity [25 (2) (a)]; and thirdly, the invoking state should not have contributed to the situation of necessity [25 (2) (b)].

<sup>839</sup> This restrictive interpretation of the customary law defence was confirmed by the ICJ in *Gabcikovo-Nagymaros Project (Hungary/ Slovakia) Judgment*, ICJ Reports 1997, p 7 - Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries (1 October 2009) available at [http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9\\_6\\_2001.pdf](http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf). Also see UNCTAD (2009).

<sup>840</sup> Burke-White and von Staden (2008); Kurtz (2010), 325; Aaken and Kurtz (2010), 859. Also see Qureshi (2009), 631; Newcombe (2011).

<sup>841</sup> Bjorklund (2009), 494; Bjorklund (2009), 479; Alvarez and Khamsi (2009); UNCTAD (2009), 80-81; Dolzer (2011), 705; Schill (2007), 265; Newcombe and Paradell (2009); Gazzini (2008), 450; Vicuna (2011), 741; Gazzini (2009); Reinisch (2007), 191; Desierto (2010); Parish (2010), 169; Salacuse (2010), 342-349; Vandevelde (2010), 178-186.



show the existence of arbitral discretion in adopting different interpretations because the law is not clear and precise enough.

Some disputes against Argentina, which involved IIAs other than the US-Argentina IIA such as the Argentina-Italy IIA which didn't had a NPM provision, the tribunal recognised that though the situation prevailing in Argentina was serious enough, the tribunal could not accept Argentina's argument that it could suspend its treaty obligations since the IIA didn't recognise any such exception.<sup>842</sup> In other words, since the treaty didn't provide for any exception, the tribunal had to judge Argentina's necessity defence under the extremely strict customary law necessity defence.

In light of this debate on investment protection and host country's regulatory power, this chapter will assess whether India can rely on NPM provisions in its IIAs to safeguard its regulatory power or not if it is found to have violated one of the substantive provisions of the IIA. In order to achieve this purpose, the chapter will interpret the NPM provisions to find out plausible interpretations and then assess the effect of these interpretations on India's regulatory power.

It is important to mention that just like one cannot have a *per se* rule for interpretation of the FET and expropriation provisions without taking into account the text of the treaty, one cannot have a *per se* rule for interpreting NPM provisions in different IIAs.<sup>843</sup> The actual interpretation of a NPM provision, in a specific IIA, will depend on the application of treaty interpretation rules given in Articles 31-32 of the VCLT. The analytical template used in this chapter to analyse the NPM provisions in Indian IIAs is same as the one used by Burke-White and Von Staden.<sup>844</sup>

The rest of the chapter is divided in six sections. Section 6.1 discusses the anatomy of NPM provisions in Indian IIAs. Section 6.2 discusses the permissible objectives (non investment

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<sup>842</sup> *Impregilo v Argentina*, ICSID Case No. ARB/07/17, 21 June 2011, paras 336-346.

<sup>843</sup> For a debate on this issue see Burke-White and Staden (2008); and Alvarez and Khamisi (2009). Also see the discussion in Kurtz (2010), 351-352. In this regard also see Burke-White and Von Staden (2010), 283, which discusses different standard of reviews that investment treaty arbitration panels can adopt to interpret NPM provisions in view of the public law character of investor-state arbitration disputes. In this regard also see the arguments of Dolzer that a treaty exception like the NPM provision should be treated in a restricted manner – Dolzer (2011), 709.

<sup>844</sup> Burke-White and Von-Staden (2008)

objectives given in the NPM provision for which India can deviate from IIA obligations) found in all the NPM provisions in Indian IIAs. Permissible objectives provide the ‘heads’ under which India can adopt different policy needs. Thus, the chapter will first discuss the strength of the existing ‘heads’ under the NPM provision for different policy-needs of India. Once this determination has been made, the chapter will then turn to study the nexus requirement in Section IV. Nexus requirement is the link between the regulatory measure adopted and the non-investment objective sought to be achieved through that measure. The discussion on nexus requirement will examine the regulatory latitude that India has under the existing NPM provisions to adopt measures for different policy-needs. Section 6.3 discusses the conditions that have to be satisfied while invoking NPM provisions in Indian IIAs.

## **6.1 ANATOMY OF NPM PROVISIONS IN INDIAN IIAs**

All the 73 IIAs, studied for this paper, contain a NPM provision. However, the NPM provisions are differently formulated. On the basis of varying textual formulation, the NPM provisions can be divided in three groups - ‘model-NPM’ type; ‘modified-model NPM’ type; and ‘Article-XX’ type.

**Table 6.1 – Different formulation of NPM provisions in Indian IIAs**

<b>Type</b>	<b>Number of IIAs</b>
Model NPM	36
Modified-Model NPM	33
Article-XX	4

*Source: Author’s study of 73 Indian IIAs.*

### 6.1.1 ‘Model-NPM’ type

36 Indian IIAs have exactly the same formulation as contained in the Indian model IIA and hence this group is called ‘model-NPM’ type. The Indian model IIA states in Article 12 (2) – ‘*Notwithstanding paragraph (1) of this Article nothing in this Agreement precludes the host*

*Contracting Party from taking action for the protection of its essential security interests or in circumstances of extreme emergency in accordance with its laws normally and reasonably applied on a non discriminatory basis*'. Article 12 (2) starts with a *non obstante* clause making it clear that in spite of whatever is stated in Article 12 (1)<sup>845</sup>, nothing in this agreement prevents the host contracting party from taking measures to fulfil the listed permissible objectives subject to specified conditions. The words '*nothing in this Agreement precludes*' gives the non-precluded character to this provision.

#### 6.1.2 'Modified-model-NPM' type

33 IIAs have NPM provisions that can be described as 'modified-model NPM' type because these provisions, though different, do not vary much from the 'model-NPM' type provisions. The difference is mainly in the form of either having more number of permissible objectives or having 'necessary' as the nexus requirement (issues to be discussed later). For example, Article 11 (2) of the India-Qatar IIA states *...nothing in this Agreement precluded the host contracting party from taking action for the protection of its essential security interests or public order or morality affecting public order or in circumstances of extreme emergency in accordance with its laws normally and reasonably applied on a non discriminatory basis*.

#### 6.1.3 'Article-XX' type

NPM provisions in four IIAs can be described as 'Article XX' type (India-Korea – Article 10.18, India-Singapore – Article 6.11, India-Japan – Article and India-Malaysia) because of it being very close to the general exceptions provision given in Article XX of GATT.<sup>846</sup> This

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<sup>845</sup> Article 12 (1) states – '*Except as otherwise provided in this Agreement, all investment shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made*'. This provision is nothing but an obvious statement that the day to day affairs of the foreign investments will be governed by the domestic laws of India.

<sup>846</sup> For example, Article 6.11 of the India-Singapore IIA gives the 'General Exceptions' provision as follows:  
*1 Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the other Party or its investors where like conditions prevail, or a disguised restriction on investments of investors of a Party in the territory of the other Party, nothing in this Chapter shall be construed to prevent the adoption or enforcement by a Party of measures:*

- (a) necessary to protect public morals or to maintain public order;*
- (b) necessary to protect human, animal or plant life or health;*
- (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Chapter including those relating to:*
  - (i) the prevention of deceptive and fraudulent practices to deal with the effects of a default on a contract;*

type of NPM provision is different from the ‘model-NPM’ type and ‘modified-model NPM’ type. In fact, it is interesting to note that these four IIAs also contain GATT Article XXI<sup>847</sup> type security exceptions (issue discussed later in the paper).

#### 6.1.4 Common Points in NPM Provisions in Indian IIAs

There is no one trend or pattern that can be discerned about the NPM provisions in Indian IIAs. For example, one can find NPM provisions belonging to all three categories signed almost at the same time. For instance, the NPM provision in India-China IIA entered in 2006 is of ‘model-NPM’ type; NPM provision in India-Saudi Arabia entered in 2006 is of ‘modified-model NPM’ type and the NPM provision in India Singapore IIA entered in 2005 is of ‘Article-XX’ type. Further, the same ‘model-NPM’ type provision exists in an IIA with a developed country like the UK and also with developing countries like Mongolia and Indonesia. The study of the NPM provisions in these 57 IIAs throws up the following important points about the structure and formulation of the NPM provisions.

First, the NPM provision start with the words ‘*nothing in this agreement precludes the host contracting party from taking action for...*’. Thus, India can move away from any IIA obligation in order to achieve certain objectives. In majority of Indian IIAs, these objectives are protection of ‘essential security interest’ (ESI) or in ‘circumstances of extreme emergency’ (CEE)<sup>848</sup> (some IIAs have other objectives also - discussed later). This means that India is prevented from taking action for any other objective that is not ESI or a CEE relying on the NPM provision.

Second, majority of NPM provisions in Indian IIAs do not contain ‘necessary’ as nexus requirement. Absence of ‘necessary’ as the nexus requirement means that a thin level of

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(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;

(iii) safety;

(d) imposed for the protection of national treasures of artistic, historic or archaeological value;

(e) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

<sup>847</sup> Article XXI of GATT allows member countries of the WTO to adopt measures to safeguard their essential security interests notwithstanding anything contained in the treaty.

<sup>848</sup> Ranjan (2008).

nexus is required between the measure taken and the objective sought to be achieved through that measure. The detailed meaning of ‘necessary’ is discussed later in the paper.

Third, it is important to note the immediate context in which the NPM provisions in Indian IIAs occur such as the title of the provision containing the NPM provision.<sup>849</sup> NPM provisions, in majority of Indian IIAs, do not occur under headings such as ‘Exceptions’ or ‘Non Conforming Measures or Non Precluded Measures’, which one would expect, given their basic character of being an exception to the treaty. In India-Russia IIA, the NPM provision is part of a provision titled ‘Promotion and Mutual Protection of Investment’. In only 11 IIAs, NPM provisions are under titles such as ‘Exceptions’<sup>850</sup> or ‘Prohibitions and Restrictions’.<sup>851</sup>

Given the divergent nature of NPM provisions in Indian IIAs, the chapter will find out how broad or narrow these NPM provisions are? A broad NPM provision (such as one that has more non-investment objectives) will offer greater scope for India to exercise its regulatory power as compared to a narrow one.

## **6.2 PERMISSIBLE OBJECTIVES**

Permissible objectives mean those non-investment objectives that are listed in NPM provisions and for which the host country can deviate from IIA obligations. For example, the NPM provision (Article XI) in the US-Argentina IIA has three permissible objectives – 1) maintenance of public order, 2) maintenance or restoration of international peace or security, and 3) protection of its own essential security interests (ESI). It is important to note the preliminary point that the host country can deviate from its substantive obligations in the IIA, relying on a NPM provision, only for those non investment objectives that are listed in the NPM provision.

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<sup>849</sup> A good example of this is given in *Plama v Bulgaria*, ICISD Case No ARB/03/24, Decision on Jurisdiction, 8 February 2005, para 147.

<sup>850</sup> India-Singapore, India-Korea, India-Italy, India-Czech Republic, India-France, India Australia, India-Bosnia Herzegovina, India-China IIAs. In India-Mexico IIA, the provision is titled as ‘Security Exceptions’, thus limiting the scope of the NPM only to security related matters.

<sup>851</sup> India-Netherlands, India-Germany IIA.

Permissible objectives in NPM provisions can be divided in two categories – ‘security’ and ‘non security’ related permissible objectives. Security related permissible objectives include objectives such as protection from ‘armed conflicts’ or ‘war’. Non security related permissible objectives include adopting measures for public health, environment etc. The ‘model-NPM’ provisions contain only ESI and CEE as the two permissible objectives. NPM provisions that are ‘modified-model NPM’ type contain more permissible objectives as compared to ‘model-NPM’ types. The most comprehensive list of permissible objectives is contained in the NPM provisions belonging to ‘Article XX’ type that contains both ‘security’ and ‘non security’ related permissible objectives. Overall, as can be seen from Table 2, NPM provisions in Indian IIAs contain fewer permissible objectives.

The discussion below will focus on different permissible objectives found in NPM provisions in Indian IIAs starting with ESI because of two reasons – first, ESI is the most common permissible objective present in 48 out of the 57 IIAs studied; and second, since Indian IIAs contain fewer permissible objectives, ESI assumes further importance, as a permissible objective, that can potentially be used both for ‘security’ and ‘non security’ concerns.

**Table 6.2 Different Permissible Objectives occurring in NPM provisions in Indian IIAs**

<b>Permissible Objectives</b>	<b>In how many NPM provisions (IIAs) are these objectives found</b>
Essential Security Interest Essential Security interest in exceptional circumstances	64 (As an independent permissible objective) India-Swiss Confederation IIA.
Circumstances of Extreme Emergency	41 (As an independent permissible objective) 5 (as linked to other objectives) – posing a threat to life or health of human beings, animals or plants or for the prevention of diseases or pests.
Public Order Sub category – Morality affecting Public Order	7 (as an independent permissible objective) 1
National Emergency or Civil Disturbances or	1

War or other forms of armed conflict	
Prevention of spread of diseases and pests in plants and animals	8 (as an independent permissible objective)
Public Health As a sub category - Prevention of spread of diseases and pests (this arguably includes not just plants and animals but also human beings)	3 6 – Including India-Singapore, India Korea, India-Japan and India-Malaysia IIAs – which provides protection of human, animal or plant life or health as the permissible objective – this is broader than mere prevention of spread of diseases and pests, however is narrower as compared to Public Health.
Public Morals	4
Morality affecting Public Order	1
Protect Environment	3
Sub category – conserve exhaustible natural resources	2

*Source: Author's survey of 73 Indian IIAs*

### 6.2.1 Essential Security Interest

The discussion on ESI in Indian NPM provisions divided between two heads - those Indian IIAs that do not contain 'self judging' language and do not have a list of activities related to ESI; and those that have self judging language and contain a list of activities related to ESI.

#### *Interpretation of ESI in NPM provisions without self judging language*

Out of the 48 IIAs that contain ESI as a permissible objective, 46 of them do not contain a self judging NPM provision. In other words, there is nothing in these 46 IIAs to show that India can unilaterally decide what constitutes ESI or unilaterally decide on the measures

adopted to achieve ESI (discussed in part IV on nexus requirement).<sup>852</sup> Thus, India's determination of ESI in these 46 IIAs can be reviewed by an arbitral body.

To use ESI as a 'ground' to deviate from IIA obligations, India will have to show that the 'security interests' are 'essential'. The ordinary meaning of the word 'essential' is 'vitally important'. Thus, to invoke ESI as a ground to deviate from IIA obligations India will have to show that the 'security interests' are most important and not ordinary. In other words, all security interests will not fall under ESI but only those that reach the threshold of 'most important'. Had the intention of the parties been that countries are allowed to deviate for all 'security interests', they would not have prefixed it with the word 'essential'.<sup>853</sup>

However, 'essential' 'security interests' in these 46 Indian IIAs does not mean only those circumstances where the very existence and independence of India is compromised, as it was held by the *Enron* and *Sempra* tribunals while interpreting ESI in the NPM provision in US-Argentina IIA.<sup>854</sup> Such situations are undoubtedly 'essential' 'security interests' and thus shall fall under ESI. However, the ordinary meaning of the word 'essential' in ESI is not limited to such situations only. The fact that India can invoke ESI only when most important 'security interests' are involved means that ESI also covers those situations which are 'severe' even if this 'severe' situation has not become 'severest' and thus not reached the highest threshold of 'compromising the existence and independence of state'.<sup>855</sup> India need not wait for the situation to reach this highest threshold before taking measures to protect it because acting at such late stage will imply that nothing will be left to protect.<sup>856</sup>

The next important issue is whether ESI in these 46 IIAs cover only pure 'security' related interests such as safeguarding the country from 'war' or 'external aggression' or do they also cover health, environmental and economic interests provided these interests fulfil the threshold of being an 'essential' interest. According to the Oxford English dictionary

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<sup>852</sup> See *CMS Tribunal* para 370; *LG&E Tribunal*, para 212; *El Paso v Argentina*, paras 591-604.

<sup>853</sup> In this regard also see the arguments on Article XXI of GATT – Schloemann and Ohlhoff (1999), 445. Also see the arguments of one author, in context of NPM provision of US-Argentina IIA (Article XI) – that the gap created in Article XI of the US-Argentina IIA by not defining ESI can be filled by the notion of 'grave and imminent peril' given in Article 25 of the ILC Article - Gazzini (2009), 18. The *Enron* and *Sempra* tribunal did the same though they equated the treaty defence with the customary law defence of necessity given in Article 25 - see *Enron tribunal*, para 333-4; *Sempra tribunal*, para 375-6. Also see Desierto (2010).

<sup>854</sup> *Enron tribunal*, para 306; *Sempra tribunal*, para 347.

<sup>855</sup> Also see *LG&E tribunal*, para 251 and 252 and *Continental tribunal*, para 180.

<sup>856</sup> Also see *Continental tribunal*, para 180.



‘security’ means the ‘state of being or feeling secure’. The state of being or feeling secure in the context of a country can mean two things. First, feeling secure from any external threat such as war or external aggression or from any other threat such as terrorist act, espionage etc. Second, feeling secure from any economic or financial crisis or any other ecological or health disaster. Both situations will require regulatory interventions and such regulatory interventions may go against India’s IIA obligations. Which regulatory intervention will be excused under NPM provision will depend on the meaning of ‘security’.

It has been argued that ESI unlike ‘war’ and ‘armed conflicts’ is a broad category and could be interpreted to include non military emergencies such as economic emergencies as well.<sup>857</sup> Similarly, according to Continental tribunal ESI must be interpreted broadly and thus a severe economic crisis will qualify as an ESI.<sup>858</sup> The International Court of Justice (ICJ) has also interpreted provisions similar to ESI, occurring in the Friendship Commerce and Navigation (FCN) treaties between US-Nicaragua by stating that *‘the concept of essential security interests certainly extends beyond the concept of an armed attack, and has been subject to very broad interpretations in the past’*.<sup>859</sup>

On the other hand, it has been argued that from a plain meaning of ESI one cannot conclude that it includes economic emergencies because ESI primarily relates to military and strategic considerations.<sup>860</sup> In context of Article XI of the US-Argentina IIA it has been argued that ‘security’ normally refers to defence and military matters.<sup>861</sup>

In light of these two different viewpoints on meaning of ESI and since Indian IIAs do not define ESI, the discussion below will show that ESI in Indian IIAs can be interpreted in two different ways – narrowly and broadly.

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<sup>857</sup> Newcombe and Paradell (2009), 497. Also see Gazzini, (2009), 15.

<sup>858</sup> *Continental tribunal*, para 178. Also see para 180-81; also see *LG&E tribunal*, para 238. Also see *CMS tribunal*, para 359; *Enron tribunal*, para 332; *Sempra tribunal*, para 374.

<sup>859</sup> US-Nicaragua Judgment (Merits) at 116. For a different understanding of these judgments see Alvarez and Khamsi (2009), 452-453.

<sup>860</sup> Reinisch (2007), 209.

<sup>861</sup> Alvarez and Khamsi (2009), 452.

## Narrow Interpretation

In order to find out which, ‘security interests’ will fall under the purview of ESI in Indian IIAs, one can have recourse to an important tool given in Article 31 (3) (c) of the VCLT, which states that any international rule applicable in the relations between the countries shall also be taken into account in interpreting the treaty. Thus, for more than 30 Indian IIAs, where India’s treaty partner is also a WTO member, one can have recourse to Article XXI (b) of GATT that gives activities related to ESI. Article XXI (b) of GATT refers to those situations of security concerns, which are essentially military type situations. It does not talk of feeling secure from any economic or financial or health crisis. Further, Article XXI (b) can be invoked only for grounds given under it<sup>862</sup> and not for any other ground.<sup>863</sup> Thus, one can argue that in the absence of a definition of ESI in these 30 Indian IIAs, the meaning of ESI can be gathered from the list of activities related to ESI given in Article XXI (b) of GATT. In other words, ESI in these IIAs will be limited to narrow ‘security’ interests limited to military type threats. A narrow interpretation of ESI, on these lines, can also be supported in light of the object and purpose of majority of Indian IIAs being investment protection and thus exception from investment protection should be narrowly construed.<sup>864</sup>

This narrow interpretation is also supported by the manner in which this term is understood in the Indian domestic legal system.<sup>865</sup> The discussion on domestic law is not to suggest, in any way, that this meaning should be imported in the treaty. The purpose is to shed light on the meaning of the treaty term while fully recognising that the source of law is the treaty and not Indian domestic law.<sup>866</sup>

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<sup>862</sup> Akande and Williams (2003), 384-385.

<sup>863</sup> In this context it has been argued that a wide range of legitimate ESIs are conceivable and in principle any policy interest of certain intensity may be legitimately protected under Article XXI - Schloemann & Ohlhoff (1999), 444. This is a broad interpretation not supported by the text of Article XXI.

<sup>864</sup> A similar argument was made by the *Enron* tribunal, supra n for NPM provision in US-Argentina IIA – see para 331. Also see *Canfor Corporation v USA and Terminal Forest Products Ltd v USA*, Decision on Preliminary Question, 6 June 2006, para 187 online <http://ita.law.uvic.ca/documents/CanforTerminalDecision6June2006.pdf> which held that exceptions in international instruments should be construed narrowly.

<sup>865</sup> For instance, while discarding the narrow interpretation of ‘essential security interest’, the Continental tribunal referred to the treaty practice of the US and the intention of US to have a NPM provision, which is broad enough to deviate from substantive obligations to preserve national interest – Continental tribunal para 181, Vandevelde (1992), 222-223

<sup>866</sup> The *CMS* (paras 200-246); *Sempra* (paras 247-256); and *Enron* (paras 218-225) tribunals looked at Argentina’s domestic law including the interpretation of emergency developed by the courts of Argentina to evaluate the measures taken by Argentina.

The Indian Constitution does not contain the phrase ESI but ‘security of the state’ in Article 19 (2)<sup>867</sup> and in Article 311 (2) (c).<sup>868</sup> The Indian Supreme Court, in *Union of India v Tulsiram Patel* stated that the phrase ‘security of the state’ cannot be confined to an armed rebellion or revolt but included other instances as well such as leaking secrets or information about defence services to outsiders, terrorist related activities, dissatisfaction in armed forces or other utterances intended or calculated to have the above effects.<sup>869</sup> The court, thus, said that there are various ways in which the ‘security of the state’ can be affected and that it is not possible to enumerate these ways.<sup>870</sup> Thus, the court’s understanding of ‘security of state’ stretches beyond armed rebellion and revolt to other security related issues such as leaking sensitive information, terrorist activities etc; however remains related to strict security related issues only and does not include other issues related to economy, health or environment within the ambit of ‘security of state’.

The court also drew a distinction between ‘security of the state’, ‘public order’ and ‘law and order’. The court held that situations that affect ‘public order’ are graver than ‘law and order’ and situations that affect ‘security of the state’ are graver than situations that affect ‘public order’.<sup>871</sup> This distinction was also emphasised in *Union of India v Ram Manohar Lohia*<sup>872</sup>. This court stated that ‘security of the state’, ‘public order’ and ‘law and order’ represented three concentric circles.<sup>873</sup> ‘Law and order’ is the biggest circle followed by ‘public order’ and ‘security of the state’ represented the smallest circle.<sup>874</sup> This interpretation certainly helps in distinguishing between situations that would threaten ‘security of the state’ from those that would threaten ‘public order’ and also from ‘law and order’.<sup>875</sup> However, this interpretation

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<sup>867</sup> Article 19 (2) provides the reasonable restrictions on the fundamental right of freedom of speech and expression and provides ‘security of the state’ as one of the reasonable restriction on the exercise of the fundamental right of freedom of speech and expression.

<sup>868</sup> Article 311 deals with dismissal, removal or reduction in rank of persons employed in civil capacities under the Union of the state. Article 311 (2) (c) states that an inquiry for the dismissal, removal or reduction in rank for a civil servant may not be conducted in cases where in the interest of the ‘security of the state’ it is not expedient to hold such an inquiry.

<sup>869</sup> *Union of India v Tulsiram Patel*, AIR 1985 SC 1416, para 143. Also see Singh (2008), 134.

<sup>870</sup> *Id.*

<sup>871</sup> *Id.*

<sup>872</sup> *Union of India v Ram Manohar Lohia*, AIR 1966 SC 740

<sup>873</sup> *Id.*, para 68.

<sup>874</sup> *Id.*

<sup>875</sup> Also see *Romesh Thapar v State of Madras*, AIR 1950 SC 124 – where the Supreme Court said that ‘security of the state’ does not refer to ordinary breaches of ‘public order’ which do not cause any threat to the state itself. Also see *State of Bihar v Shailabala Devi* AIR 1952 SC 329 where incitement to commit violent crimes like murder was held to be endangering the ‘security of the state’.

does not shed much light on what kinds of emergencies or situations will constitute threats to ESI for India to deviate from its IIA obligations.

An example in the Indian Constitution that links ‘security of the state’ to security related emergencies is given in Article 352. It provides that if the President of India is satisfied that a grave emergency exists whereby the security of India is threatened whether by war or external aggression or armed rebellion he may by proclamation make a declaration to that effect.<sup>876</sup> In this Article the phrase used is ‘security of India’ and not ‘security of the state’. However, both the phrases mean the same thing. This Article gives three instances where ‘security of India’ could be threatened – war, external aggression and armed rebellion.<sup>877</sup> It does not refer to any other situation that could threaten the ‘security of India’ such as economic, health or environmental emergency. However, Article 360 of the Indian constitution refers to financial emergency.<sup>878</sup> Notwithstanding this, arguably, ‘security of the state’ within Indian domestic law is confined to only military and police related threats or conditions and does not include other non security related factors.

### Broad Interpretation

A broad interpretation of ESI implies an interpretation where ‘state of being or feeling secure’ includes both - security from external threat or war – and - security from non military threats. It can be argued that ESI in these 46 Indian IIAs cannot be limited to the list of activities given in Article XXI of GATT because in all these IIAs, ESI is open ended. ESI has been kept open ended because unlike in India-Singapore and India-Korea IIA, in no other Indian IIA a distinction has been made between ‘security’ and ‘non security’ permissible objectives. Thus, ESI is intended to cover both ‘security’ and ‘non security’ policy objectives. Had the parties intended to limit the meaning of ESI only to ‘security’ objectives, they would have expressly done that. Furthermore, there is a key distinction between Article XXI of GATT and the NPM provisions in these 46 Indian IIAs – the former is self judging whereas

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<sup>876</sup> Proclamation under Article 352 (national emergency) has been done on three occasions. ‘War’ was the reason on two occasions and ‘internal disturbance’ was the reason on the third occasion.

<sup>877</sup> Singh (2008), 953. The phrase ‘armed rebellion’ was added by the 44<sup>th</sup> amendment to the Constitution replacing the phrase ‘internal disturbance’ – which had a broader connotation as compared to ‘armed rebellion’ which is narrower and more specific. For more on this see – *Naga People’s Movement of Human Rights v. Union of India*, AIR 1998 SC 431. Also see – Subramaniam (2000), 134.

<sup>878</sup> Financial emergency has never been invoked in India till date.

the latter are not.<sup>879</sup> In other words, the context (an integral part of treaty interpretation under Article 31 (1) and (2) of VCLT) of the NPM provisions in Indian IIAs is different from the context of Article XXI of GATT. Thus, ESI in NPM provisions in Indian IIAs has a different meaning from ESI in GATT Article XXI.

#### Limitations of ESI as a permissible objective

The critical outcome of the above discussion is that a narrow interpretation of ESI will certainly restrict India's regulatory power. Even if a broader interpretation is adopted, which goes beyond a pure military threat approach, due to the presence of the word 'essential', it will include only those situations that are of a high threshold or situations of gravity which can be described as a serious threat to India's security interest. Burke-White and Von Staden in their 2010 paper have argued that giving adequate margin of appreciation to countries in public law matters like dealing with an 'essential' 'security interest' will allow regulatory latitude to countries to use NPM provisions for their national needs.<sup>880</sup> A deferential standard of review within the treaty interpretative framework will certainly help India in situations like a grave economic crisis engulfing the entire country to decide when does an economic crisis reach the threshold of an 'essential' 'security interest' and hence serve India's regulatory power. However, it cannot be used to cover those policy needs that require adoption of measures that might affect the rights of foreign investors such as adopting measures to boost domestic industry in situations of economic downturn or adopting measures to boost industrial development in certain regions of the country. Such policy objectives, though important, will fail to satisfy the requirement of an 'essential' 'security interest' when ESI is interpreted using the VCLT rules of treaty interpretation as discussed above. In other words, in such situations, ESI will be inadequate as a permissible objective notwithstanding the deferential standard of review followed by an ITA tribunal.

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<sup>879</sup> Kurtz has argued against using ESI in Article XXI of GATT to interpret ESI in Article XI of the US-Argentina IIA (personal communication with Dr J. Kurtz - on file with author). Also see Kurtz (2010), 363-364 for using human rights law to interpret ESI in US-Argentina IIA.

<sup>880</sup> Burke-White and Von Staden (2010).

### *Interpretation of ESI in NPM provisions containing self judging language*

There are four Indian IIAs – India-Korea, India-Singapore, India-Japan and India-Malaysia which contain ‘self judging’ language in the NPM provision. Article 10.18(2)(b) of India-Korea<sup>881</sup> and Article 6.12 (1) (b) of India-Singapore IIA<sup>882</sup>, which are almost mirror images of GATT Article XXI (b), provide that nothing in the investment chapter shall be construed to prevent a party from taking any actions ‘*which it considers*’ necessary for the protection of its ESI. This chapeau is then followed by a list of activities related to ESI.<sup>883</sup> The words, ‘*which it considers*’, in the respective provisions of these two IIAs imply that the host state will unilaterally determine the legality of measures taken to meet ESI. Thus, these words confer greater deference to the host state in determining which measure to adopt to achieve the desired permissible objective<sup>884</sup> (this issue will also be discussed later in the section on necessity requirement).

The interesting question is whether the self judging language also applies to indentifying what is an ESI. This can be interpreted in two ways:

#### First Interpretation

Article 10.18 (2) (a) of India-Korea IIA states that a country is not required to furnish any information, the disclosure of ‘*which it considers*’ contrary to its ESI. In other words, this provision allows India to consider whether the disclosure of information is contrary to its

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<sup>881</sup> Article 10. 18 (2) provides - *Nothing in this Chapter shall be construed:*

(a) *to require a Party to furnish any information, the disclosure of which it considers contrary to its essential security interests;*

(b) *to prevent a Party from taking any actions which it considers necessary for the protection of its essential security interests;*

(i) *relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials or relating to the supply of services as carried on, directly or indirectly, for the purpose of supplying or provisioning a military establishment;*

(ii) *taken in time of war or other emergency in international relations;*

(iii) *relating to fissionable and fusionable materials or the materials from which they are derived; or*

(iv) *to protect critical public infrastructures for communications, power and water supply from deliberate attempts intended to disable or degrade such infrastructures*

<sup>882</sup> Article 6.12 (1) (a) and 6.12 (1) (b) [chapeau] of India-Singapore IIA is same as Article 10.18 (2) (a) and 10.18 (2) (b) [chapeau] of India-Korea IIA respectively, given above.

<sup>883</sup> See Articles 10.18 (2) (b) (i)-(iv) of India-Korea IIA, given above and Articles 6.12 (1) (b) (i)-(iv) of the India-Singapore IIA.

<sup>884</sup> Burke-White and von Staden (2008), 369.

ESI. India can decide on whether disclosing particular information will adversely affect its ESI only if it is allowed to decide, free of review, what this ESI is. Hence, if India can determine ESI under sub clause (a), free of review, then India should be allowed to self decide what constitutes an ESI under sub clause (b) also. It will be unusual if India is allowed to determine its ESI under paragraph (a) but not under paragraph (b). Same argument applies for India's IIAs with Singapore, Japan and Korea, which contains similar provisions.<sup>885</sup>

### Second Interpretation

Notwithstanding the above argument, there is a fundamental difference in sub clause (a) and sub clause (b). Sub clause (a) does not provide a list of activities related to ESI; whereas in sub clause (b), ESI is related to a list of activities and situations.<sup>886</sup> This list contains all military type threats or where the security of the state is endangered due to a war. Thus, arguably, in sub clause (a), ESI has a broader scope as compared to sub clause (b).

Further, in all four IIAs such as Articles - 10.18 (2) (b) of India-Korea and 6.12 (1) (b) of India-Singapore IIA, '*which it considers*' (the self judging phrase) is placed between 'taking any actions' and 'necessary'.<sup>887</sup> Thus, India can only decide the necessary measures to be adopted for the protection of ESI. There is nothing in the provision to show that the host state also has to decide, on its own, what constitutes an ESI for the purpose of sub clause (b).

On the basis of these arguments, one can argue that ESI can be self determined in sub clause (a); but not in sub clause (b).

Thus, different arguments can be made on whether the determination of ESI by the host state under sub clause (b) is reviewable or not by the arbitral tribunal; what is certain is that determination of ESI under sub clause (b) can only be for the activities or situations given under the clause and not for any activity that falls outside this clause.<sup>888</sup> In other words, even if India were to self determine ESI under sub clause (b), that self determination can only be for the list of activities given under sub clause (b).

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<sup>885</sup> In this regard also see the arguments on Article XXI of GATT - Akande and Williams (2003), 397.

<sup>886</sup> See *supra* note 863.

<sup>887</sup> See *supra* notes 863 and 864.

<sup>888</sup> Also see Sornarajah (2010), 460 who has made this point with regard to India-Singapore CECA.

This is supported by the context (Article 31 (1) of VCLT) in India-Singapore, India-Korea, India-Japan and India-Malaysia IIAs. For example, in India-Singapore IIA, ESI, as a permissible objective, occurs under the heading ‘security exceptions’ distinct from ‘general exceptions’ provision. The ‘general exceptions’ provision covers other permissible objectives such as public health, public order, public morals, conservation of exhaustible natural resources. Similarly in India-Korea IIA, although ESI falls under the generic heading ‘Exceptions’, Article 10.18 (3) states that Article 10.18 (2) (which gives ESI provision) shall be interpreted in accordance with the ‘understanding’ of the parties on ‘Security Exceptions’.<sup>889</sup> Thus, Article 10.18 (3) provides that ESI, in India-Korea IIA, has been conceived and adopted as ‘security exceptions’. Further, India-Korea IIA, like India-Singapore IIA, has provisions where NPMs can be adopted under categories like ‘public health’ and public order’.

It can be argued that countries intended to limit interpretation of ESI, in these IIAs, because of the presence of other permissible objectives in the ‘non security’ part of the NPM provision. Thus, in case of a public health emergency, India does not need ESI and can rely on the ‘public health’ permissible objective occurring in the ‘non security’ part of the NPM provision in both the IIAs.

### Non Justiciability

Three IIAs (India-Singapore, India-Korea and India-Malaysia) provide that the ‘security exceptions’ are non-justiciable. For instance, Annex 10 C of the India-Korea IIA provides that

*‘...any decision of the disputing Party taken on such security considerations shall be non-justiciable in that it shall not be open to any arbitral tribunal to review the merits of any such decision...’*,

This provision makes it amply clear that the arbitral tribunal cannot review the action of the host states related to the security considerations and this will include the determination of

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<sup>889</sup> Article 10. 18 (3) provides – “Paragraph 2 shall be interpreted in accordance with the understanding of the Parties regarding Security Exceptions for Investment and Non-justiciability of Security Exceptions set out in Annexes 10-B and 10-C respectively, which shall form an integral part of this Agreement”.



ESI. It has been argued that the purpose behind making security exceptions non justiciable is to avoid uncertainties as to the application of the security related measures.<sup>890</sup>

Since these provisions are non-justiciable, India can self determine both the ESI and the measure to be adopted to achieve this ESI. Thus the debate on whether ESI can be self determined under both the sub clauses (a) and (b) in these two IIAs is immaterial. However, even then, India can determine ESI in sub clause (b) of both the IIAs only with regard to the list of activities provided and not with regard to those activities not given in sub clause (b). Doing otherwise will be against the intent of the countries as reflected in the text.

It has been argued that this type of express non-justiciable language will push the invocation of the security exception completely outside the purview of arbitral review even with regard to whether it was made in good faith.<sup>891</sup> Complete preclusion might result in India abusing its regulatory power.

#### 6.2.2 Circumstances of Extreme Emergency

Before discussing CEE, it is important to mention that strictly speaking CEE is not a permissible objective. CEE actually means circumstances that are of extreme emergency where India can deviate from IIA obligations provided other conditions are satisfied. So, it essentially refers to certain circumstances and not to an objective that India seeks to achieve like ESI. However, in the chapter, CEE is discussed as a permissible objective because it is capable of including different regulatory objectives within its ambit.

The Indian Constitution provides for three types of emergencies – national emergency (Article 352), emergency in states due to failure of constitutional machinery (Article 356) and financial emergency (Article 360). Article 352 talks of ‘grave emergency’, which can exist only in three cases – war, external aggression and armed revolt. As mentioned above, Article 360 talks of ‘financial emergency’. The term, ‘grave emergency’ has not been defined in Indian Constitution and also not interpreted by the Indian courts since a proclamation of emergency under Article 352 has been made only on three occasions and thus there has not been much judicial adjudication on this. However, the Supreme Court ruling in *Naga*

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<sup>890</sup> Newcombe and Paradell (2009), 494-495.

<sup>891</sup> *Id.*, 495. This point has been made specifically about the India-Singapore IIA but will hold for India-Korea as well, which contains a similar provision.

*People's Movement v India*<sup>892</sup>, threw some light on when can a situation be called 'grave emergency'. The Apex Court while discussing the 44<sup>th</sup> Amendment to the Indian constitution that replaced the condition 'internal disturbance' by 'armed rebellion' in Article 352, observed that the intention behind this substitution is to limit the invocation of the emergency powers under Article 352 only to more serious situation where there is threat to the security of the country and thus to exclude situations of internal disturbance which are of lesser gravity. More clarity on 'emergency provisions' in Indian constitution comes from Article 356, which gives the second type of emergency that can be imposed in India. This type of emergency is imposed when government of a state cannot be carried out in accordance with the provisions of the Indian constitution. In *Rameshwar v India*<sup>893</sup>, a case related to Article 356, the Supreme Court said that resort to emergency provision has to be in exceptional circumstances when there is real and grave situation calling for drastic action.<sup>894</sup>

In context of IIAs, CEE exists in 41 NPM provisions in Indian IIAs as an independent permissible objective as shown in Table 2. In 5 IIAs, this permissible objective is linked to other permissible objectives. For example, in India-Denmark IIA, the provision is - '*In circumstances of extreme emergency for the prevention of diseases or pests*'. The plain meaning of a provision like this is that it refers to only those circumstances of extreme emergency which are related to prevention of diseases or pests and not to all circumstances of extreme emergency. Similarly, India-Spain IIA provides '*in circumstances of extreme emergency posing a threat to life and health of human beings, animals and plants*'.

In CEE the word 'emergency' is preceded by the word 'extreme'. The word 'emergency', according to the English Oxford dictionary connotes a serious, unexpected, and potentially dangerous situation requiring immediate action. This word is preceded by 'extreme'. By giving ordinary meaning to the terms used, as per Article 31 (1) of VCLT, the presence of the word 'extreme' before 'emergency' implies an even higher threshold for invocation and thus the situation has to be 'very serious' and 'very potentially dangerous', not just 'serious' or 'potentially dangerous' to qualify as CEE.<sup>895</sup> Therefore, CEE represents the existence of an exceptional circumstance whereby there is a real and grave situation calling for drastic action. In such circumstances, India can invoke CEE not just on grounds related to security concerns

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<sup>892</sup> *Naga People's Movement of Human Rights v Union of India* AIR 1998 SC 431.

<sup>893</sup> *Rameshwar Prasad and Others v Union of India* AIR 2006 SC 980.

<sup>894</sup> Id, Also see Burke-White and von Staden (2008), 368.

<sup>895</sup> Burke-White and Staden (2008), 367.

but also on grounds related to health<sup>896</sup> (such as a spread of an epidemic) or environment or a major political crises or natural disasters<sup>897</sup> provided the high threshold as warranted by CEE is reached. This is because the text of the IIA does not limit invoking CEE only for pure security related threats. In the absence of any explicit or implicit restriction on purposes for which CEE can be invoked in Indian IIAs, the correct interpretation is that CEE can be invoked for all policy needs provided the ‘extreme emergency’ threshold is reached. However, CEE also has its limitations as a permissible objective. Even if India is granted a deferential standard of review as argued by Burke-White and Von Staden<sup>898</sup> to judge whether the ‘extreme emergency’ threshold has been reached in a particular circumstance; it will be extremely difficult for India to justify measure adopted for a policy need such as adopting measures to boost industrial development in a backward region as a ‘circumstance’ of ‘extreme emergency’. In other words, deferential standard of review is useful in providing regulatory latitude to India; however such deference will operate within the treaty interpretative framework and hence cannot be used if a policy need cannot be brought under the ambit of CEE as understood pursuant to the application of the VCLT treaty interpretation tools.

The formulation in India-Italy and India-Uzbekistan IIAs is noteworthy because it imposes a lower degree of threshold by the use of the terms ‘*emergency*’ and ‘*national emergency*’ respectively, not prefixed with the word ‘extreme’.

### 6.2.3 Public Order

Public Order as a permissible objective occurs in eight Indian IIAs as an independent permissible objective as shown in Table 2. Out of these, four IIAs (India-Qatar – Article 11.2, India-Argentina – Article 6.2, India-Portugal – 12.2, and India-Saudi Arabia – 14.2) are

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<sup>896</sup> In case of a health emergency, it is important to make an additional point related to the Doha Declaration on TRIPS and Public Health especially for those Indian IIAs that have been entered into with WTO member countries. The declaration states that each country has the right to determine what constitutes a national emergency or circumstances of extreme urgency in matters related to health. Thus, it provides the flexibility to countries to define a public health emergency in a manner supportive of its health needs. For those Indian IIAs with countries who are also WTO members, and using Article 31(3)(c) of the VCLT, this provision can be relied upon to establish the existence of a public health emergency under CEE where public health is not given as a separate permissible objective – see the Doha Declaration on TRIPS and Public Health WT/MIN (01)/DEC/2, 20 November 2001

<sup>897</sup> UNCTAD (2009), 77

<sup>898</sup> Burke-White and Von Staden (2010).

‘modified-model NPM’ type IIAs and four of them (India-Korea – Article 10.18, India-Singapore – Article 6.11, India-Japan – Article 11 and India-Malaysia – Article 12.1) are ‘Article-XX’ type. India-Qatar IIA provides not just for ‘public order’ as a permissible objective but also for ‘morality affecting public order’. One can find out the meaning of the term ‘public order’ by giving ordinary meaning to the terms used. ‘Public’ in the shorter Oxford English dictionary means ‘*of or pertaining to people as a whole*’.<sup>899</sup> ‘Order’ in the shorter Oxford English dictionary means ‘*a condition in which the laws regulating the public conduct of members of a community are maintained and observed; the rule of law or constituted authority; absence of violence or violent crimes*’.<sup>900</sup> Reading the two together means that ‘public order’ implies a situation where affairs related to people as a whole, which are reflected in the society’s public policy and laws are maintained and observed. Every society’s public policy and laws regulating the affairs of its people are different and hence India should be given some regulatory latitude in applying concepts like ‘public order’ based on what India considers is its fundamental interest or affair pertaining to its people as a whole within the treaty interpretative framework.<sup>901</sup>

The *Continental* tribunal interpreted ‘public order’ in a broad manner and held that an economic crisis could also result in putting ‘maintenance of public order’ at stake.<sup>902</sup> The *Continental* tribunal said that ‘public order’ is intended as a broad synonym for ‘public peace’ which can be threatened by actual or potential insurrections, riots and violent disturbances of the peace.<sup>903</sup>

One can also have recourse to Article 31 (3) (c) of the VCLT to substantiate and further shed light on ‘public order’ in these six Indian IIAs. Since all the six countries (Qatar, Argentina, Portugal, Saudi Arabia, Singapore and Korea) are WTO member countries along with India, one can look at the WTO agreement. Article XIV of the WTO General Agreement on Trade in Services (GATS) mentions public order as a permissible objective for which a country can deviate from GATS obligations. However Article XIV does not define ‘public order’ though

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<sup>899</sup> *United States Measures Affecting the Cross Border Supply of Gambling and Betting Services, Report of the Panel (US-Gambling, Panel Report)*, WT/DS285/R, para 6.463.

<sup>900</sup> *Id*, para 6.466

<sup>901</sup> In this regard also see the arguments of Burke-White and Von Staden that deference should be accorded to states in interpreting public order because such concepts are deeply rooted in domestic legal and political practices of different states - Burke-White and Staden (2008), 360

<sup>902</sup> *Continental Tribunal*, para 180-181.

<sup>903</sup> *Id*, para 174, para 180. On the other hand, it has also been argued that ‘maintenance of public order’ is primarily related with civil unrest – Reinisch (2007), 209.

footnote 5 to Article XIV (a) states that public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.

The WTO Panel while interpreting ‘public order’ in Article XIV of GATS in *US-Antigua gambling*<sup>904</sup> recognized that the content of a concept like ‘public order’ for countries can vary in time and space, contingent upon a series of factors such as existing social, cultural, ethical and religious values<sup>905</sup> and hence countries should be given some scope in defining and applying concepts such as ‘public order’ based on their own values and systems,<sup>906</sup> which was later upheld by the AB.<sup>907</sup> After recognizing that countries enjoy some deference in defining ‘public order’, the tribunal said that as a matter of effective treaty interpretation it should give meaning to the term ‘public order’.<sup>908</sup> Thus, after considering the dictionary meanings and footnote 5 to Article XIV (a) of GATS, the tribunal held that “*public order refers to the preservation of the fundamental interests of a society, as reflected in public policy and law. These fundamental interests can relate, inter alia, to standards of law, security and morality*”.<sup>909</sup>

Article 27.2 of the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) contains the term ‘*ordre public*’, which is a French term and is deemed to be narrower than public order.<sup>910</sup> Although *ordre public* is not defined in the TRIPS agreement; Article 27.2 mentions that *ordre public* includes the protection of “*human, animal or plant life or health or to avoid serious prejudice to the environment*”, thus indicating towards its broad interpretation.<sup>911</sup> In European law *ordre public* encompasses protection of public security and physical integration of individuals as part of the society.<sup>912</sup>

The Indian Supreme court in *Supdt v Lohia*<sup>913</sup>, said that the expression ‘public order’ is synonymous with public peace, safety, and tranquillity.<sup>914</sup> Courts have held that public order implies absence of violence and an orderly state of affairs, in which citizens can peacefully

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<sup>904</sup> *United States- Measures Affecting the Cross Border Supply of Gambling and Betting Services, Report of the Appellate Body, Adopted 20 April 2005, (US-Gambling, AB Report) WT/DS285/AB/R.*

<sup>905</sup> *US- Gambling, Panel Report*, para 6.461.

<sup>906</sup> *Id.* Also see Burke-White and Staden (2008), *supra* note 31, 360; ICTSD-UNCTAD, 379.

<sup>907</sup> *US-Gambling*, AB Report, para 296-299.

<sup>908</sup> *US-Gambling*, Panel Report para 6.462.

<sup>909</sup> *Id.*, para 6.467. Also see Kurtz (2010), 360-361; also see Trebilcock and Howse (2005), 518.

<sup>910</sup> *Id.*

<sup>911</sup> ICTSD-UNCTAD (2004).

<sup>912</sup> *Id.*, 379.

<sup>913</sup> *Supdt., Central Prison v Ram Manohar Lohia* AIR 1960 SC 633.

<sup>914</sup> *Id.*, para 11.

pursue their normal avocation of life<sup>915</sup> and that it signifies absence of disorder which involves breaches of local significance.<sup>916</sup>

Thus, what follows from the discussion above is that India should be able to make use of ‘public order’ as a permissible objective in order to adopt measures in cases of health, economic and environment exigencies provided India is able to show that Indian society’s fundamental interest or affair related to people as a whole has been disturbed or is at risk. Within the treaty interpretative framework of the VCLT, India will also have due deference in this regard. However, the major limitation is that India will be able to do so only in case of eight IIAs, as the rest 65 do not contain ‘public order’ as a permissible objective.

#### 6.2.4 Public Health

Another important permissible objective is ‘public health’. However, only three Indian IIAs contain ‘public health’ as a permissible objective – India-Mauritius (Article 11.3), India-Japan (Article 11) and India-Malaysia (Article 12.1). Article 11 (3) of the India-Mauritius IIA allows the host country to impose prohibitions or restrictions of any kind to protect ‘public health’. A somewhat related formulation is given in India-Korea and India-Singapore IIA. The NPM provision in these IIAs states *‘protection of human, animal or plant life or health’* as the permissible objective.

India-Spain IIA provides *‘circumstances of extreme emergency posing a threat to the life or health of human beings, animals or plants’* as the permissible objective. This goes beyond mere public health and also includes life and health of animals and plants. Thus, in this sense, is broader than ‘public health’. However, *‘threat to life or health of human beings, animals or plants’* is prefixed by the phrase *‘circumstances of extreme emergency’*. Thus, measures to protect human, animal, plant life or health are to be taken only when circumstances of extreme emergency pose a threat to their life and health and not otherwise. This formulation is narrower than *‘protection of public health’* given in India-Mauritius IIA.

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<sup>915</sup> Basu (1996), 1230.

<sup>916</sup> Singh (2008), 135.

A further narrowing of the permissible objective is evident in India-Germany, India-Italy, India-Czech Republic, India-France, India-Belgo-Luxembourg Economic Union, India-Australia, India-Kuwait and India-Malaysia IIAs where the permissible objective is stated as '*circumstances of extreme emergency for the prevention of diseases*'. Thus, this health related objective can be used only for adopting NPMs for the prevention of diseases and that too only in circumstances of extreme emergency and not for other reasons related to life or health of humans, animals and plants.

#### 6.2.5 Environment

Barring four Indian IIAs (with Singapore, Korea, Japan and Malaysia), none of the Indian IIAs have 'environment' as a permissible objective. In the India-Korea IIA, Article 10.18 (1) (b) allows the host country to take measures necessary to protect environment. Apart from this, the same IIA also contains a permissible objective related to environment which allows the host country to take measures necessary to conserve exhaustible natural resources [Article 10.18 (1) (e)]. India-Singapore IIA, unlike the India-Korea IIA, does not contain '*protection of environment*' as a specific permissible objective. Rather, it allows the host country to deviate from its IIA obligations by taking measures related to '*conservation of exhaustible natural resources*'. This formulation, though related to environmental protection, is narrower in scope in comparison to '*protection of environment*'.

Furthermore, both India-Singapore and India-Korea have environment as one of the objectives in the provision titled '*measures in the public interest*'. Thus, under both the IIAs, India can adopt an environmental measure if adopting such a measure is in public interest. Similar focus for protection of environment exists in India-Japan and India-Malaysia IIAs. This particular provision coupled with the NPM provision gives enough regulatory power to India to fulfill its environmental needs in these four IIAs. In rest of the Indian IIAs, reliance on NPM provision for environmental purposes will be difficult.

#### 6.2.6 Other permissible objectives

Some other permissible objectives present in Indian IIAs are Public morals (India-Korea and India-Singapore IIA), morality affecting public order (India-Qatar – Article 11.2); protection

of national treasures of artistic, historic or archaeological value (India-Korea and India-Singapore IIA); and taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security (India-Korea and India-Singapore).

### **6.3 NEXUS REQUIREMENT**

Nexus requirement in a NPM provision is the link between adopted measures and the permissible objective sought to be achieved through that measure. For instance, in the Indian Model IIA the word that links ‘nothing precludes the host country from taking action’ and ‘protection of its essential security interests’ is ‘for’. Thus ‘for’ is the nexus requirement in this NPM provision. Other words that often occur in NPM provisions as nexus requirement are ‘necessary’ ‘related to’ ‘directed to’ etc.

**Table 6.3 Nexus Requirement in Indian NPMs**

<b>Nexus Requirement</b>	<b>In how many NPM provisions in Indian IIAs</b>
Necessary for/to	22. In some of the IIAs, ‘necessary’ as the nexus requirement is present in different versions. For example in India Morocco – ‘strictly necessary’; in India-Kuwait – ‘necessary reasonable measures’; and in India-Singapore, India-Japan and India-Korea – ‘necessary’ is the nexus requirement for some permissible objectives and not for all.
For	47.
Applying Measure ‘To’	1 (India-Uzbekistan IIA – Article 13.2).
‘Relating to’.	1 (India-Singapore IIA for the permissible objective ‘conservation of exhaustible natural



	resources’).
‘Directed to’	1 (India-Mauritius IIA – Article 11.3).
Apply prohibitions or restrictions ‘in’	1 (India-Italy IIA – Article 12).

*Source: Author’s survey of 73 Indian IIAs*

As one can see from Table 3, out of 57 IIAs studied, 34 of them have ‘for’ as the nexus requirement and only 19 have ‘necessary’ as the nexus requirement. Other nexus requirements are - ‘to’, ‘relating to’, and ‘directed to’. The significance of the nexus requirement is in establishing the degree of connection between the adopted measure and the permissible objective sought to be achieved. The stricter the nexus requirement, the stricter will be the degree of connection between the measure adopted and the permissible objective sought to be achieved. Thus, a nexus requirement like ‘necessary’ is stricter as against ‘related to’.<sup>917</sup>

The discussion below will examine the meaning of the word ‘necessary’ and then subsequently will look at the meaning of the other ‘nexus requirements’ in Indian IIAs.

### 6.3.1 Necessity Requirement

The discussion on ‘necessary’ as the nexus requirement in Indian IIAs is under two heads – ‘necessary’ in NPM provisions that are non self judging and those that are self judging – India-Korea and India-Singapore. In these two IIAs, the ‘non-security’ exception contains ‘necessary’ as the nexus requirement, but is not self judging. Only the ‘security’ exceptions are self judging.

#### *‘Necessary’ in Non self judging NPM provision*

As it has been mentioned above, ‘necessary’ as a nexus requirement in the NPM provision occurs only in 22 Indian IIAs. In India-Kuwait IIA, the nexus requirement is ‘strictly necessary’. Thus, in this IIA, India will have to show that the measure is ‘strictly necessary’ and not just ‘necessary’ requiring an even stricter nexus. Another interesting variation to be

<sup>917</sup> In this regard, see the WTO ruling in *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2 and 4, Report of the Appellate Body, 29 April 1996, 17-18.

noted is in India-Austria and India-Finland IIAs, which state ‘*taking necessary action in abnormal circumstances*’... Thus, India will have to show that the measure is ‘necessary’ and that ‘abnormal circumstances’ exist.

However, in other NPM provisions where the word ‘necessary’ has not been qualified, the question is - should ‘necessary’ be interpreted using the customary defence of necessity as it was done by the *CMS*, *Enron* and *Sempra* tribunals while interpreting ‘necessary’ in the NPM provision in the US-Argentina IIA. These three tribunals read the customary law necessity defence given in Article 25 into the treaty defence and came to the conclusion that since Argentina’s measures didn’t satisfy Article 25, the measures were illegal.<sup>918</sup> However, the LG&E tribunal first used Article XI (the NPM provision) and subsequently used Article 25 to support its conclusion that the measures were consistent under Article XI.<sup>919</sup> The *CMS* annulment committee, the *Continental* tribunal and the *Sempra* annulment committee emphasized on the difference between the two provisions and held that Article XI of the US-Argentina IIA differed in material respects from Article 25.<sup>920</sup> The scholarly opinion on these cases is divided.<sup>921</sup> Recently, an arbitral tribunal in *El Paso v Argentina*, used the customary law ‘necessary’ doctrine to interpret ‘necessary’ in Article XI of the US-Argentina IIA. The tribunal used Article 31(3) (c) of the VCLT to borrow Article 25(2) (b) of the ILC Draft Articles (state cannot use the ground of necessity if it has contributed to the situation) into Article XI of the US-Argentina IIA.<sup>922</sup> As it has been discussed elsewhere, Article 31(3) (c) of the VCLT provides ‘*any relevant rules of international law applicable in the relations between the parties*’. Thus, the tribunal concluded that Article 25(2) (b) is a general rule of international law and hence a ‘relevant rule’ under Article 31(3) (c).<sup>923</sup>

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<sup>918</sup> *CMS Tribunal*, para 304 onwards; para 353-78; *Enron tribunal*, para 333-334, para 339; also see the discussion in Newcombe and Paradell (2009), 494-495; *Sempra Tribunal*, paras 375 & 378.

<sup>919</sup> Reinisch (2007), 208; Binder (2009), 614-615. Also see Kurtz (2010), 355-356 for criticism of the methodology adopted by the *LG&E* tribunal.

<sup>920</sup> *Sempra Annulment*, para 198; *Continental tribunal*, para 167; *CMS Annulment*, para 129. On this also see Dolzer (2011), 714-715.

<sup>921</sup> See Bjorklund (2009), 493; Alvarez and Khamsi 2009, for supporting the analysis of the *CMS*, *Enron* and *Sempra* tribunals. For different views see - Kurtz (2010); Burke-White and von Staden (2008); Dolzer and Schreuer (2008); Gazzini (2009); Bottini (2008). Also see the discussion in Newcombe and Paradell (2009), 494-495; Subedi (2008), 189-191; Salacuse (2010), 342-348; Sornarajah (2010), 455-465. For a critique of the *Continental* tribunal see Dolzer (2011).

<sup>922</sup> *El Paso v Argentina*, paras 613-626.

<sup>923</sup> *Id*, paras 613-621. the tribunal also went on show, very summarily, that Article 25(2) (b) of the ILC Articles is also a ‘general principle of law recognised by civilized nations’ by stating the UNIDROIT principles on international commercial contracts in support of its conclusion – para 623. The *Continental* tribunal had said that this particular provision of the customary defence of necessity ‘cannot be the yardstick as to the application of Art. XI of the BIT’ – see para 234. Also see A Martinez (2010) *Invoking State Defences in Investment Treaty Arbitration* in M Waibel *et al* (eds) *The Backlash Against Investment Treaty Arbitration*, 315 at 323.

*El Paso* tribunal's reasoning leaves one wondering why only Article 25(2) (b) of the ILC Articles was discussed as a 'relevant rule' under Article 31(3) (c) of the VCLT to interpret 'necessary' in the NPM provision. Article 25 of the ILC Articles, as mentioned above; provides four factors, related to the invocation of 'necessity', including the factor that a country cannot invoke necessity if it has contributed to the situation of necessity. Thus, why were other factors like the one given in Article 25(1) (a) which requires that the invoked measure must be 'the only way' for the state to safeguard its essential interest. This provision is also a rule of customary law and hence one fails to understand the conspicuous failure of the tribunal to explain why Article 25(1) (a) is or is not a 'relevant rule' under Article 31(3) (c) of VCLT to interpret 'necessary' in Article XI.<sup>924</sup> Further, while the tribunal used all the treaty interpretation rules given in Article 31 of the VCLT in deciding whether Article XI of the US-Argentina IIA is self-judging,<sup>925</sup> it didn't discuss any of these rules in interpreting 'necessary' in Article XI. It simply relied on Article 31(3) (c) of the VCLT and brought in Article 25(2) (b) into the treaty defence without fully appreciating the differences in the 'context' of the treaty exception from the customary law necessity doctrine.

On the basis of this theoretical analysis, the majority in the tribunal, in a severe indictment of sovereign ability of a country to adopt economic policies that it prefers, concluded that since Argentina had contributed to the economic crisis by adopting faulty economic policies, it cannot invoke the 'necessary' defence, given in the IIA, notwithstanding the existence of an extremely severe political, economic and social situation.<sup>926</sup> In other words, notwithstanding the severest economic, social and political crisis that Argentina faced, it could not rely on the treaty exception that was agreed by the countries to remedy such situations because two arbitrators were of the view that Argentina had contributed to the crisis and hence it cannot invoke the treaty exception. Arbitrator Stern, on the panel, disagreed with the majority that Argentina had contributed to the economic crisis. This also shows the degree of subjectivity involved in deciding these complex issues.

'Necessary' in the NPM provisions in Indian IIAs is different from Article 25 for two reasons. First and most important, in Indian IIAs adoption of necessary measures is subject to

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<sup>924</sup> See Gazzini (2008) on this.

<sup>925</sup> *El Paso v Argentina*, paras 588-610.

<sup>926</sup> *Id*, para 656.

the following condition - measures should be applied on normal, reasonable and non discriminatory basis (see section V). These conditions are completely different from the conditions that have to be fulfilled in invoking Article 25. Thus, the intent clearly is to have a different meaning of ‘necessary’ from Article 25.

Second, interpreting ‘necessity’ requirement in NPM provisions in accordance with the stringent requirements of necessity in Article 25 and in a manner where the latter supplants the former shall make the treaty defence (NPM) inseparable from the customary law defence of necessity and thus will render NPM provisions in Indian IIAs futile. If Indian treaty makers intended to use the Article 25 defence to achieve the permissible objectives given in NPM provisions, there was no need to have a NPM provision because the customary defence is anyway available. Article 25 deals with wrongfulness in international law whereas the NPM provision in Indian IIAs deal with those alleged violations of the IIA that can be excused under the treaty.<sup>927</sup> Another reason advanced by Burke-White and Von Staden for ‘necessary’ in NPM provisions to be interpreted differently from the strict standard of review of Article 25 of the ILC Articles is based on the context of the term – ‘necessary’ occurs in the NPM provision which is a general exception and hence indicates that the term ‘necessary’ is intended to provide countries with some flexibility in achieving the permissible objectives.<sup>928</sup>

This brings us to the next issue in interpreting ‘necessary’ in these 22 Indian IIAs. Although the NPM text and context in Indian IIAs makes it clear that it is different from Article 25 and thus the meaning of ‘necessary’ is not just indispensability and that India should have some flexibility in deciding which measures are ‘necessary’ to achieve its permissible objectives; the ‘ordinary’ meaning of the word ‘necessary’ (under Article 31 of the VCLT) gives room for the application of two tests<sup>929</sup> - the least-treaty-inconsistent-alternatives-reasonably-available test (LTIARA)<sup>930</sup>; and a proportionality or a weighing and balancing test, where the LTIARA test could be one part.<sup>931</sup>

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<sup>927</sup> *Sempra* Annulment, para 200-203. Also see Desierto (2010).

<sup>928</sup> Burke-White and Von Staden (2010), 296. Also see Binder (2009), 617-620 for the argument that the potential of Article 31(3) (c) of the VCLT to reconcile treaty and customary law standards, in case of necessity, is limited.

<sup>929</sup> Burke-White and von Staden (2008), 343.

<sup>930</sup> Bown and Trachtman (2009), 87.

<sup>931</sup> In this regard also see the arguments of Burke-White and Von Staden (2010) who argue for a margin of appreciation test based on the jurisprudence of the European Court of Human Rights.

The WTO jurisprudence on ‘necessary’ in GATT Article XX and GATS Article XIV has developed a two tier test involving both proportionality and LTIARA<sup>932</sup> - first, the proportionality or the weighing and balancing test will weigh and balance different factors like the importance of the regulatory value pursued, the contribution made by the challenged measure to the regulatory value and the restrictive effect of the measure on international trade; second, if the first step yields a preliminary conclusion of the measure being ‘necessary’, then the second step should compare this measure with other least trade restrictive measures, which are reasonably available to the importing country<sup>933</sup> - the LTIARA test. The proportionality test in WTO has been critiqued for encroaching onto the host country’s sovereignty because it allows the WTO adjudicator to compare trade and non-trade values and based on this assessment, the adjudicator can replace the importing country’s assessment with his/her own assessment.<sup>934</sup>

The Continental tribunal used the WTO Article XX jurisprudence<sup>935</sup> to determine whether Argentina’s measures satisfied the test of ‘necessity’. The Continental tribunal asked the following questions - whether the measures contributed materially to the realization of ESI (the legitimate aim under Article XI)<sup>936</sup>, and whether a reasonable alternative measure, consistent to the IIA, which yielded the same result might have been available to Argentina.<sup>937</sup> The tribunal answered the first question in the affirmative<sup>938</sup> and the second

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<sup>932</sup> See the WTO Jurisprudence on ‘necessary’ in GATT Article XX and GATS Article XIV - *Korea-Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS 161 and 169/AB/R, 11 December 2000; *Dominican Republic - Measures Affecting the Importation and Internal Sale of Cigarettes (Dominican-Republic - Cigarettes)*, WT/DS320/AB/R, adopted 25 April 2005; *US-Gambling* supra note 81 and 110; *Brazil-Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, 17 December 2007.

<sup>933</sup> Diu (2010), 1093.

<sup>934</sup> Bown and Trachtman (2009), 85; Regan (2007), 348; Ortino (2005), 35-36; Kurtz (2010), 366-368. In context of GATT Article XX, also see Eeckhout (2010), 18-20 who has argued that that if intrusion in importing country’s sovereignty is the ground to oppose ‘weighing and balancing’ test, then even the ‘least restrictive test’ is also intrusive because it involves complex questions such as whether a reasonably alternative measure is available that achieves the same level of benefit - which is difficult to quantify.

<sup>935</sup> For more on the GATT Article XX test see - Trebilcock & Howse (2005), 525-538; Eeckhout (2010), 3. Mavroidis (2005), 190-194; Ortino (2005). For more on weighing and balancing test see - Kurtz (2010), 365-366. Also see Newcombe (2011), 363 who has supported the use of GATT Article XX jurisprudence to interpret general exception clauses in IIAs. Also see Muchlinski (2009) and the jurisprudence of the European Court of Human Rights such as *Handyside v. United Kingdom*, (5493/72) [1976] ECHR 5.

<sup>936</sup> *Continental* tribunal, *Id*, para 196

<sup>937</sup> *Id*, para 198.

<sup>938</sup> *Id*, para 197.

question negatively<sup>939</sup> and thus came to the conclusion that measures adopted by Argentina were ‘necessary’ to protect its ESI.<sup>940</sup>

In context of ITA, the arbitral tribunal should not engage in finding out how the benefit of the goal will balance against the restrictive effect on investment.<sup>941</sup> Given the debate on IIAs and ITAs intruding too much on host country’s regulatory power and the institutional position of arbitrators; once it is established that the host country’s regulatory measure falls under one of the permissible objectives, the arbitral tribunal should only engage in finding out whether a less investment restrictive measure is reasonably available<sup>942</sup> to the host country that would achieve the same benefit. If indeed such a measure is available, then the measure adopted by the host country should be held not ‘necessary’. Thus, the LTIARA test will serve India’s regulatory power better by dissuading the arbitral tribunal from judging the relative importance of India’s regulatory objective with the restriction on foreign investment. Furthermore, by requiring that only least investment restrictive measure, which is reasonably available to the host country be adopted, this test will also ensure that foreign investment is not unduly restricted.

However, in the absence of meaning of ‘necessary’ in the NPM provision in 19 Indian IIAs, both the tests are applicable and it will depend on arbitral discretion as to which standard of review is followed in interpreting ‘necessary’.<sup>943</sup> Furthermore, another demonstration of arbitral discretion is the analysis undertaken by the *El Paso* tribunal. Thus, an arbitral tribunal can even interpret ‘necessary’ in these Indian IIAs using elements of the customary law of necessity and thus have the same result that the methodology of confluence will have.<sup>944</sup> While one concedes that Article 31(3) (c) of the VCLT can be used to bring in customary rules of international law for the interpretation of the treaty, it is also important to note that

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<sup>939</sup> *Id.*, paras 200-219.

<sup>940</sup> The only measure of Argentina that the *Continental tribunal* found not satisfying the requirement of ‘necessity’ was related to restructuring of the Treasury bills – para 221. The use of WTO jurisprudence by the *Continental tribunal* has attracted some criticism because the structure of Article XI of the US-Argentina IIA is different from Article XX of GATT – Bjorklund and Nappert (2010); Desierto (2010); Alvarez and Brink (2010).

<sup>941</sup> Kurtz (2010), 369.

<sup>942</sup> A measure should be held to be reasonably available only if it is practically possible for the host country to adopt such a measure – See *US Gambling*, AB report, para 308.

<sup>943</sup> Also see the argument made by Burke-White and Von Staden (2010), for adopting ‘margin of appreciation’ as the standard of review.

<sup>944</sup> On using Article 25 of the ILC Articles to interpret ‘necessary’ in the NPM provision occurring in the IIA see – Dolzer (2011), 715-716; Vicuna (2011), 741-750; Gazzini (2008).

this does not mean a blind importation of the customary law into the treaty.<sup>945</sup> Such importation has to be consistent with the overall ‘context’ of the treaty defence; else it will not be consistent with the scheme of the IIA. As it has been mentioned above, the NPM provision in Indian IIAs are drafted very differently from the stringent elements given in Article 25 of the ILC Draft Articles and hence have a different context from the context in which Article 25 contains its key elements. Reading rules of necessary under the customary law defence into the treaty exception by relying on Article 31(3) (c) of the VCLT, without fully appreciating the context of the treaty exception, means bringing the methodology of confluence through the back door to effectively negate the regulatory power of the host nation.

*‘Necessary’ in NPM provisions containing self judging language*

In India-Singapore, India-Korea IIA, India-Japan and India-Malaysia the chapeau of the ‘security’ exception clause allows countries to adopt measures, which the countries consider are necessary for the protection of ESI, as it has been mentioned before.

The presence of the phrase, ‘*which it considers*’, before ‘necessary’ in these four IIAs means that the determination of whether the measures are necessary or not will be made by India for achieving the ESI. In this regard, a question arises whether a ‘good faith’ review of the ‘necessary’ measures adopted is nevertheless possible?

In context of Article XXI of GATT it has been argued that although a WTO panel cannot determine whether the measure adopted by a state under Article XXI is necessary to protect its security interests; nevertheless, a ‘good faith’ review of the measure is possible.<sup>946</sup> This ‘good faith’ review should examine whether the country considered (genuinely believed) the measure to be taken necessary to tackle the essential security threat.<sup>947</sup> Complete preclusion from judicial review may result in countries abusing the self judging NPM provision and

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<sup>945</sup> On this point see Qureshi (2006), 23 for the point that Article 31(3) (c) of the VCLT ‘*is about interpretation and not about amendment or modification*’. Also see Sands (1999).

<sup>946</sup> See Akanade and Williams (2003), 389, 393-399; Schloemann & Ohlhoff (1999), 443; 444-445.

<sup>947</sup> Id.

adopting protectionist measures and thus not balancing investment protection with host state's regulatory power.<sup>948</sup>

However, as mentioned above, the security exception in all these four IIAs are non-justiciable and thus even a 'good faith' review of the 'necessary' measure may not be possible.

### 6.3.2 Non 'necessary' nexus requirements

More than 35 Indian IIAs do not contain 'necessary' as the nexus requirement but other requirements like 'for', 'relating to', 'to' and 'directed to'. In fact, majority of Indian IIAs (32 out of 57 studied) have 'for' as the nexus requirement. It has been argued that 'for' as the nexus requirement suggests a relatively thin nexus whereby measures will be allowed as long as they merely further a permissible objective.<sup>949</sup> A weak nexus requirement, like 'for' implies that India will be able to adopt a large number of measures to achieve permissible objectives (provided it is able to show that there exists a permissible objective as per the NPM provision) even if such measures are not 'necessary'. However, the presence of 'for' as the nexus requirement creates a genuine apprehension that the NPM provision could be abused by India. With 'for' as the nexus requirement India can adopt a large range of measures to achieve a permissible objective even if other least restrictive alternative measures are reasonably available.

Similarly, the nexus requirement, 'relating to', suggests a weaker nexus requirement as compared to 'necessary'<sup>950</sup> though stronger than nexus requirement like 'for'. In *US-Shrimp*, in the WTO, 'relating to' was interpreted to mean that there should be a rational connection between the measure taken and the objective sought to be achieved.<sup>951</sup> India-Singapore IIA has 'relating to' as the nexus requirement for the objective of conservation of 'exhaustible natural resources'. A nexus requirement like 'relating to' will imply that the arbitral tribunal only has to see whether there is a rational connection between the measure adopted the objective sought to be achieved. This gives more regulatory power to India.

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<sup>948</sup> See Burke-White and von Staden (2008), 378 who argue for a residual 'good faith' review; also see Vandevelde (1993), 176.

<sup>949</sup> *Id.*, 342.

<sup>950</sup> Trebilcock and Howse (2005).

<sup>951</sup> *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 October 1998, para 135-142.



#### **6.4 ADDITIONAL CONDITIONS IN IIAs TO WHICH NPMs ARE SUBJECTED TO**

Indian NPM provisions subject adoption of NPMs to certain conditions as mentioned above. For example, the NPM provision in India Model IIA states that measures adopted to meet the permissible objectives must be '*in accordance with its laws normally and reasonably applied on a non discriminatory basis*'. A condition such as this is intended to ensure that measures, adopted to achieve permissible objectives, should be applied in a manner that is just and rationale. These conditions are applicable for all permissible objectives whether ESI, CEE or other objectives like protecting the spread of diseases and pests. In other words, even when India has to act for its security interests, which are serious in nature (meeting the high threshold of ESI), it has to adopt NPMs on a normal, reasonable and non discriminatory basis.

Amongst Indian IIAs, as many as 48 IIAs have the same condition as given in the Indian Model IIA. These 48 IIAs include both 'model-NPM' type IIAs and 'modified-model NPM' type IIAs. There are another 12 IIAs that contain conditions, which are in slight variation from the one contained in these 32 IIAs. For example, India-Netherlands (Article 12), India-France (Article 12) and India-Bosnia Herzegovina (Article 12) IIAs states that measures adopted should be imposed in a non discriminatory manner and in good faith. Similarly, India-Croatia (Article 12.2) IIA, apart from the requirement that measures adopted should be applied normally, reasonably and on a non discriminatory basis, also includes the requirement of imposing measures on a non arbitrary basis. The NPM provision in India-Bosnia Herzegovina IIA, apart from the non-discriminatory requirement, also states that measures adopted should give same treatment to all investors in like situations.

India-Singapore, India-Korea, India-Japan and India-Malaysia IIAs contain many elaborate conditions in the form of a chapeau like the chapeau of Article XX of GATT or Article XIV of GATS. These conditions are same as those given in the chapeau of GATT Article XX and GATS Article XIV. On other hand, a few Indian IIAs such as India-Germany, India-Russia and India-Argentina do not contain any such conditions for the application of the measures under the NPM.

## ***SUMMARY***

The NPM provision plays a key role in providing host countries with regulatory flexibility to deviate from investment protection to pursue non-investment related policy objectives. This chapter has shown that the NPM provision in majority of Indian IIAs is formulated in a narrow manner that will not be enough to safeguard India's regulatory power by balancing it with investment protection. Barring the Indian IIAs with Korea, Singapore, Japan and Malaysia none of the IIAs contain a well formulated NPM provision. The nexus requirement in majority of Indian IIAs is weak and does not require 'necessary'.

## CHAPTER 7

### CONCLUSION

The concluding chapter notes the two key conclusions of the thesis (Section 7.1 and 7.2) and suggests a way forward to balance investment protection with India's regulatory power (Section 7.3)

#### ***7.1 VAGUE TREATY PROVISIONS***

The first key conclusion of the thesis is that provisions on expropriation, FET, MTP and NPM provisions in majority of Indian IIAs are vague, broad and indeterminate.<sup>952</sup> The discussion on the expropriation provision in 73 Indian IIAs shows that 'limited-content' expropriation provisions occurring in 57 Indian IIAs neither defines expropriation nor provides the factors that need to be taken into account to determine indirect expropriation. The only indicator present in these 57 IIAs is to focus solely on effect of the measure to determine indirect expropriation, which should be same as effect that would result had the investment been directly expropriated. Thus, the implied reference is to the 'substantial deprivation' test. Only 16 Indian IIAs, provide factors that should to be taken into account in determining indirect expropriation. These factors focus both on the effect of the measure on foreign investment and the character of the measure *i.e.* whether the measure was adopted to pursue a genuine policy objective. Some IIAs, out of these 16, focus on proving intention to expropriate and provide an absolute safe haven to pursuing policy objectives.

The chapter on the FET provision shows that in as many as 66 Indian IIAs, there is no indication regarding the meaning of the FET provision. Only 5 IIAs provide some indication regarding the content of the FET standard by linking it with MST of aliens under CIL. The provisions on monetary transfer in 58 Indian IIAs provide unqualified right to foreign investors to transfer funds and do not recognise any exceptions to this right. Only in 15 Indian IIAs, the provisions on monetary transfer provision recognise certain exceptions to the right of the foreign investors to transfer funds.

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<sup>952</sup> Also see IISD (2012).

The chapter on NPM provision shows that in majority of Indian IIAs, the NPM provision contains limited permissible objectives such as ‘essential security interest’ and ‘circumstances of extreme emergency’. NPM provisions in only 4 Indian IIAs allow India to deviate from its treaty obligations to pursue a wide range of policy objectives like environment and public health apart from essential security interest.

## **7.2 EXPANSIVE INTERPRETATIONS**

The second key conclusion of the thesis is that these vague, broad and indeterminate provisions can be given interpretations giving precedence to investment protection over India’s regulatory power. These vague and broad provisions give lot of discretion to ITA tribunals, which have interpreted similar provisions in other IIAs in ways that limit host state’s regulatory powers. For example, 57 Indian IIAs that indirectly refer to the ‘substantial deprivation’ test do not provide any further indication regarding ‘substantial deprivation’ of which investment. This opens up the possibility of different plausible interpretations such as examining whether investment as a whole has been substantially deprived to find indirect expropriation or severing investor’s investment into different property rights and then applying the ‘substantial deprivation’ test to each of these property rights to determine indirect expropriation. Higher degree of severance could result in more regulatory measures being held expropriatory. Further, due to the vagueness of treaty provisions, ITA tribunals have come up with three different tests to determine indirect expropriation leading to confusion over which test should be used if an Indian regulatory measure is challenged as expropriation under any of the Indian IIAs.

Likewise, the FET chapter has demonstrated that FET has emerged as the most important treaty provision for foreign investors to challenge host country’s regulatory power. Rules of treaty interpretation are of limited value in case of FET provisions in 66 Indian IIAs that do not provide any indication regarding the content of the FET standard. The scope of arbitral discretion here is much larger. As the FET chapter has shown that some ITA tribunals give a lower threshold for the violation of the FET provision whereas some tribunals provide a higher threshold. All tribunals have said that honouring investor’s legitimate expectations is an integral part of the FET provision. Some tribunals like *Tecmed*, *MTD*, *Occidental*, *CMS*,

have given an expansive interpretation to legitimate expectations stating that bringing changes in the regulatory framework could violate investor's legitimate expectations. On other hand some tribunals like *Saluka* call for a more balanced interpretation to determine whether investor's legitimate expectations have been breached or not. These divergent rulings have created confusion regarding the actual content of the FET standard in these 66 Indian IIAs. Further, even in those Indian IIAs that link the FET provision with MST of aliens under CIL, one is unsure of the actual content of the FET provision due to the problems in determining the content of the international minimum standard.

Due to the broad provision on monetary transfer in majority of Indian IIAs, India's capital control measures aimed at achieving different policy objectives may be challenged as violation of India's obligations contained in MTP. India will be able to defend its capital control measures only in 15 Indian IIAs where the MTPs recognise restrictions on the rights of the investor to transfer funds.

Barring 4 Indian IIAs, the NPM provisions in Indian IIAs do not allow India to deviate from its IIA obligations for many important policy objectives because the NPM provision recognises a narrow set of permissible objectives. Thus, if India wishes to deviate from an IIA temporarily because it wishes to promote indigenous industries in a backward region of India which otherwise cannot compete with foreign corporations, it will not be able to do so without running the risk of its regulatory measure being challenged under the IIA. Further, the nexus requirement of 'necessary' can be interpreted differently as the ITA tribunal rulings show. Some ITA tribunals like *CMS*, *Enron* and *Sempra* interpreted 'necessary' in the NPM provision by relying on the stringent defence of necessity found in customary international law. On the other hand, some ITA tribunals like *Continental* interpreted 'necessary' by relying on the Article XX WTO jurisprudence. Moreover, as the NPM chapter has shown, 'necessary' in the NPM provision in Indian IIAs can be interpreted either using the 'least restrictive test' or the proportionality test, which further adds to the confusion regarding the meaning of 'necessary'.

### **7.3 WAY FORWARD – BALANCING INVESTMENT PROTECTION WITH INDIA’S REGULATORY POWER**

One approach that can be adopted to balance investment protection with India’s regulatory power is to interpret IIAs in a manner that balances investment protection and host state’s regulatory power.<sup>953</sup> This can also be described as using the ‘interpretative-route’ to address the legitimacy concerns of the ITA system using different standards of review<sup>954</sup> such as doctrine of proportionality<sup>955</sup> or using the doctrine of ‘margin of appreciation’.<sup>956</sup> Schill has argued that to increase the legitimacy of the ITA system, the need is to focus on ‘system-internal’ approaches.<sup>957</sup> Such an approach means conceptualising the ITA system as a public law discipline and interpreting IIAs using a public law method, namely comparative public law.<sup>958</sup> This puts the burden on arbitrators to strike a balance between investment protection and host country’s regulatory power.

The ‘interpretative-route’ has many challenges in balancing investment protection with host country’s regulatory power. The biggest challenge is that the ‘interpretative-route’ cannot completely overcome the weaknesses in the substantive law *i.e.* the IIAs. There is only so much that arbitrators can do if the IIAs does not include provisions that balance investment protection and regulatory power of the host state.<sup>959</sup> For example, if countries have not included sustainable development in the IIA, it will be difficult for arbitrators to bring sustainable development into the case.<sup>960</sup> An IIA cannot be interpreted with certain objective in mind without taking into account the language of the treaty. Interpreting an IIA in order to achieve a certain objective without being mindful of the language of the treaty goes against the basic canons of treaty interpretation required under international law. For example, the expropriation chapter has shown that while the ‘police power’ test, advocated by some arbitral tribunals, is an attempt to show that IIAs do not come in way of countries exercising

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<sup>953</sup> Cheng (2006), 1016; Franck (2005), 1588.

<sup>954</sup> See Burke-White and Von Staden (2010), 283.

<sup>955</sup> Krommendijk and Morijn (2009), 422; Newcombe and Paradell (2008), 363-65; Kingsbury and Schill (2009).

<sup>956</sup> Choudhary (2008), 823-27. Also see Bjorklund (2011) who argues that ‘margin of appreciation’ in interpreting FET may result in arbitrary treatment of those in developing countries.

<sup>957</sup> Schill (2011), 61.

<sup>958</sup> *Id.* Also see Montt (2009). Also see Vadi (2010), 67 – who argues that one needs to be careful while adopting the comparative method to the ITA system.

<sup>959</sup> Stern (2010).

<sup>960</sup> *Id.* Also see Brower II (2009), 354-355 – who though supporting a bottom up approach to improving the ITA system by emphasizing on the role that arbitrators, scholars and practitioners can play, also cautions on the cost of such reliance.

their regulatory power, it goes against the plain language of the IIA. When applied in context of Indian IIAs, it poses many conceptual problems because the language of many Indian IIAs does not support such a test.

Another serious challenge for the ‘interpretative-route’ to balance investment protection with host country’s regulatory power is the lack of consistency and coherence in arbitral jurisprudence that has emerged so far. One arbitral award being different from another or lack of coherence, in itself, should not come as a surprise in a regime that has multitude of IIAs existing at the bilateral level. Each IIA is different from another and hence there are bound to be differences in the interpretation of the provisions. Further, there is no appellate system that could play a role in bringing the required coherence.<sup>961</sup>

However, the deeper problem is that same IIA provision has been interpreted differently by different ITA tribunals. On the one hand, some ITA tribunals like *Total*<sup>962</sup> have held that the FET provision should be interpreted in a manner that balances investment protection with host state’s regulatory power; many other tribunals like *CMS* and *Enron* have given FET an investor-friendly meaning.<sup>963</sup> Similarly, as the NPM chapter has shown, different interpretative approaches were adopted by arbitral tribunals to interpret the same treaty defence of necessity.

The thesis has discussed these different interpretative techniques that can be adopted to balance investment protection with host country’s regulatory power. For example, the NPM chapter has shown ‘margin of appreciation’ is useful in according deference to India to decide when the threshold is reached to invoke the permissible objective of ‘essential security interest’. Thus, India will be able to use ‘margin of appreciation’ in a situation of serious economic crisis or a serious national security to decide whether the threshold for the invocation of the NPM provision has reached. However, such deferential standard of review

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<sup>961</sup> Alvarez (2005), 97. Also see Brower II (2009), 354-355 – who though supporting a bottom up approach to improving the ITA system by emphasizing on the role that arbitrators, scholars and practitioners can play, also cautions on the cost of such reliance. Disparity in the results of ITA rulings will further widen because differences in different treaty texts are becoming more profound with more and more countries introducing more detailed and substantive IIA provisions - Alvarez (2011), 636. Thus, one IIA may simply refer to the requirement to provide FET without providing what it contains. Whereas another IIA may provide the content of such FET by stating that providing FET requires each member state not to deny justice in any legal or administrative proceedings in accordance with the principles of due process - See Article 11(2) of the ASEAN Comprehensive Investment Agreement.

<sup>962</sup> *Total SA v Argentina*, ICSID Case No. ARB/04/1, 27 December 2010.

<sup>963</sup> See chapter 4 on FET for more details.

will be of limited value for those policy needs, which cannot be brought under the ambit of ‘essential security interest’ pursuant to formal treaty interpretation rules such as an industrial policy favouring domestic industries for the backward region of India. The solution to justify such policy needs under the NPM provision is not to provide India a deferential standard of review, but to have a NPM provision that recognises and allows India to deviate from its IIA obligations for such policy needs.

Likewise, the chapter on expropriation has discussed that use of ‘doctrine of proportionality’, as one of the interpretative techniques to balance investment protection with host country’s regulatory power, gives much discretion to *ad-hoc* arbitrators who are not embedded in the judicial system of the host country and do not understand the social values and ethos of that country and hence are not qualified to decide on extremely complex value laden judgments. It is contentious whether placing such high onus on international arbitrators to judge value laden policy objectives is appropriate.

Professor Subedi has argued that ‘*the business of developing law of foreign investment is too important an area to be left to some ad hoc tribunals established under ICSID or UNCITRAL*’.<sup>964</sup> Hence, the onus should primarily be on countries. This brings us to the ‘reformulation-route’, which focuses on reformulating the IIA to balance investment protection with host country’s regulatory power. The recent treaty practice suggests that countries are keen to take control in their hands to balance investment protection with regulatory power and not leave it to the arbitrators. There is more and more evidence of countries wanting to make sure that their IIAs are more precise and clear so as to avoid unexpected restrictions on regulatory power. Many countries are re-negotiating their IIAs as a direct response to arbitral tribunal decisions that have brought to the fore new insights regarding the inherent risks in IIAs containing broadly defined provisions.<sup>965</sup> Examples of such treaty practice have been given in the introductory chapter. Countries are making changes in their IIAs to negate expansive arbitral jurisprudence. For example, in the final draft of the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR), the MFN provision is limited to establishment, acquisition, expansion, management, operation and the like and does not include matters related to dispute settlement – a clear indicator of

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<sup>964</sup> Subedi (2006), 139

<sup>965</sup> Clodfelter (2009), 168. Also see Spears (2010), 1048. Also see Footer (2009), 36.



rejecting the ruling given in *Mafezzini v Kingdom of Spain* and thus prohibiting an expansive interpretation of MFN.<sup>966</sup>

Often the possibility of re-negotiating IIAs is dismissed as an extremely difficult exercise.<sup>967</sup> This argument ignores the evidence on countries successfully re-negotiating their IIAs. A good example is of the Czech Republic, which has renegotiated 22 IIAs over the last two to three years. India has made amendments to three IIAs with Bulgaria, Romania and the Czech Republic as discussed in the chapter on MTPs and NPM provisions, thus clearly showing that renegotiation or making amendments in IIAs is certainly possible. Further, the global evidence tells us that from 1998 to 2008, 132 IIAs have been renegotiated.<sup>968</sup>

Another argument could be that re-negotiating IIAs involves transaction cost, and hence India may be deterred from doing so. While re-negotiating an IIA certainly involves transaction cost, as is for re-negotiating all international treaties, it is not as difficult a job as is often made out because most IIA obligations are undertaken at the bilateral level and in many cases, like that of India, are entered for 10 years with the option of reviewing the IIA after this period. Thus, an opportunity to review an IIA presents itself every 10 years. Further, re-negotiating a bilateral treaty is easier in comparison to renegotiating a multilateral treaty like the WTO, for example. India has a pretty successful track record in renegotiating Double Taxation Avoidance Agreements (DTAAs), signed bilaterally, in order to address concerns related to tax evasion and black money. In the period from 2009 to 2011, India has renegotiated 21 of its existing DTAAs.<sup>969</sup> Thus, if bilateral DTAAs can be renegotiated, bilateral IIAs can also be renegotiated.

Furthermore, renegotiating an IIA does not mean that all IIAs have to be renegotiated overnight. It can be done over a period of time. Further, if India thinks that renegotiating the entire IIA with all countries is not practicable, it can at least issue joint clarifications or interpretations of different terms or provisions like FET that have been heavily litigated and whose meaning has been a cause of concern. Such joint clarifications or interpretations can

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<sup>966</sup> For more on this see – Chalamish (2009), 331.

<sup>967</sup> Susan Franck (2010) as quoted in A Bjorklund (2010); Franck (2005), 1588-89.

<sup>968</sup> UNCTAD IIA Monitor 2008-2009).

<sup>969</sup> Black Money: Government 'Seriously Considering' Amnesty Scheme, The Hindu, September 14, 2011 available at <http://www.thehindu.com/news/national/article2452848.ece>

play a major role in clarifying the meaning of the vague IIA terms and hence become an important treaty tool for interpretation using Articles 31(3) (a) and 31(3) (b) of the VCLT.

Moreover, even if one concedes that India will be deterred from re-negotiating its existing IIAs so as to reformulate them due the high transaction cost involved or find it difficult for other reasons, the outcome of such review can still be applied to the new IIAs that India is negotiating or wishes to negotiate in future. Furthermore, nothing stops India from amending its model IIA, which arguably can be used as a treaty interpretation tool under Article 32 of the VCLT.<sup>970</sup>

At any rate, it is important to note that the process of reviewing and then clarifying the substantive law (which is to be done by India and its IIA partner country) and the process of developing well accepted and reasoned jurisprudential principles through adjudication that balance the interests of investors and host states (which is to be done by arbitrators) are not mutually exclusive.

It is important to point out that by emphasising on renegotiation of IIAs, one is not stressing on overly specific definitions aiming to cover all potential dispute situations.<sup>971</sup> Hence there will always be room for interpretation of IIAs and hence the role of arbitrators is indispensable. However, the quest is to have clarity in the law to be interpreted so that key treaty provisions do not remain as vague and as indeterminate as they currently are; and that interpretations of these vague and indeterminate provisions do not surprise host countries. Renegotiated and re-drafted IIAs or adoption of authoritative interpretations of vague provisions will provide a better sense and indication of the intent of the countries. Even arbitrators will welcome clear and non-vague treaty provisions or indicators in the IIA that will help them enormously to rightly ascertain the meaning of key provisions.

The thesis gives below the elements that could be made part of the four key provisions studied in the thesis.

### *Expropriation*

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<sup>970</sup> Salacuse (2010)

<sup>971</sup> See Franck (2005), 1589 on this.

In order to balance investment protection with India's regulatory power, expropriation provision in all Indian IIAs be reformulated by specifying that expropriation is to be determined relying on the substantial deprivation test. In order to make it clearer that indirect expropriation occurs when there is effect equivalent to direct expropriation, India could consider putting a phrase like '*effect equivalent to direct expropriation without formal transfer of title or outright seizure*' in its IIAs. Such a phrase exists in four Indian IIAs (India-Singapore, India-Korea, India-Japan and India-Malaysia). Further, the reformulated IIA should also make it clearer that this deprivation should be for the investment activity as a whole and not for 'taking' individual property rights so as to make sure that tribunals do not indulge in conceptual severance and India is not penalised for those acts that do not substantially deprive foreign investment as a whole. The expropriation provision in the 'content-indicative' IIAs also needs to be reformulated to get rid of the proportionality and purpose-only test and contain the substantial deprivation test for the investment activity as a whole. Further, bonafide and non discriminatory regulatory measures that the current formulation of the 'content-indicative' IIAs wants to protect from being labeled as expropriatory can be better protected under a suitably drafted NPM provision to help balance investor protection with India's regulatory power. The reformulated expropriation provision focusing on substantial deprivation test along with a reformulated NPM provision will achieve the same objective that the 'content-indicative' formulation of expropriation provision in the IIAs seeks to achieve; however with a more clearer and effective treaty interpretation methodology that integrates different parts of a treaty rather than the methodology that conflates different standards. The formulation clearly pointing to a substantial deprivation test will mean that India's regulatory measures that merely have economic disadvantage on foreign investment are not held expropriatory and at the same time will protect investment better by allowing investors remedy in cases where regulation crosses the threshold of substantial deprivation. After all, this is the very purpose why countries agree to an expropriation provision in IIAs. For those situations where a non discriminatory regulatory measure implemented by following due process for an important bonafide public purpose crosses the threshold line, India can always invoke the NPM provision to excuse the violation. This will also have the advantage of deterring an arbitral tribunal from second guessing which public purpose is important to warrant excuse in liability and which doesn't.

## FET

Indian IIAs should provide the meaning of the FET provision in order to make sure that arbitral tribunals do not give interpretations that might result in unexpected restrictions on India's regulatory power. As the chapter on FET provision shows that linking the FET provision with the minimum standard in customary international law does not help much because of the indeterminate nature of the MST of aliens under CIL. In this regard, guidance can be drawn from the ASEAN Comprehensive Investment Agreement, where Article 11 (2) states that *fair and equitable treatment requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process*'.<sup>972</sup> Thus, a provision like this limits FET to denial of justice. India could consider having a FET provision which clearly links fair and equitable treatment to denial of justice and gross arbitrariness. This will help India to adequately protect its regulatory power by desisting an arbitral tribunal from adopting an expansive interpretation of the FET provision and at the same time allow foreign investors protection from grossly arbitrary actions of the Indian state.

## MTPs

To draw guidance for the reformulation of MTPs in Indian IIAs, one can look at the MTPs in other IIAs.<sup>973</sup> For example, Article 12 of the Korea-Japan IIA, like majority of Indian IIAs also allows for a wide range of transfers in freely convertible currencies at the market exchange rate and without delay. However, Article 12 also contains an exception which allows the host country to delay or prevent a transfer in cases of bankruptcy, insolvency or the protection of the rights of creditors; criminal or penal offences etc.<sup>974</sup> Apart from this exception, and more importantly, this treaty has another exception contained in Article 17. Article 17 allows the host country to adopt measures restricting capital transactions in the event of serious BoP difficulties and also in cases where capital movement causes or threatens to cause serious difficulties for macroeconomic arrangement – like monetary and

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<sup>972</sup> Ewing-Chow (2011).

<sup>973</sup> In this regard also see the argument that '*Reforming treaties in order to grant individual nations and the global community the policy space to deploy capital account regulations to prevent and mitigate financial crises is fairly simple at the technical level but quite difficult at the political level*' – Gallagher (2012), 129.

<sup>974</sup> See Article 21 (3) of the Korea-Japan IIA

exchange rate policies.<sup>975</sup> Protection of such non-monetary objectives in MTPs is evident in other IIAs – like – Article 7 of the US-Uruguay IIA which allows the contracting party to prevent a transfer through equitable, non-discriminatory and good faith application of its laws for purposes like protection of rights of creditors, or for criminal or penal offences.<sup>976</sup>

India-Mexico, India-Korea and India-Singapore IIAs also provide a good model for the reformulation of MTPs. As discussed, these IIAs not only allow the host country to temporarily deviate from free transfer right for monetary objectives like a BoP crisis but also for other non-monetary objectives like protection of rights of creditors. These IIAs also establish consistency between different international obligations by referring to the IMF Articles. This sort of formulation is better than the model followed in those Indian IIAs that make transfers subject to national laws because there is a possibility of abuse by the host state by simply changing its domestic laws and thus it will tilt the scale too much in favour of India's regulatory power against investment protection. A MTP provision, which clearly lists the grounds for deviation, not only allows the host country to exercise regulatory power but also protects foreign investment and investor's rights.

Thus, the reformulated MTP, in order to balance investment protection with India's regulatory power should contain the following elements - it should allow the investor to transfer all funds related to investment in a convertible currency at the market rate of exchange; it should recognize clear exceptions to this right by allowing India to impose capital controls on such transfers provided such restrictions are imposed on an equitable and non discriminatory manner; the grounds for imposing such restrictions should cover – both monetary and non monetary objectives; monetary objectives should include not just severe BoP crisis or external financial difficulty but also other monetary objectives like maintaining a healthy exchange rate (as given in the Korea-Japan IIA) or preventing too much volatility in the stock market; such restrictions should be consistent with the IMF Articles to make sure that there is consistency in India's international obligations pertaining to capital transfer; the MTP could create a distinction between portfolio investment and FDI in terms of imposing

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<sup>975</sup> See Article 17 (1) (a) & (b) of the Japan-Korea IIA.

<sup>976</sup> See Article 7 (4) of the US-Uruguay IIA.

restrictions because portfolio investments are volatile whereas FDI is more stable though, at times, it might not be easy to distinguish between portfolio investment and FDI.<sup>977</sup>

One may question whether instead of providing exceptions within the MTP why not use the NPM provision to move away from the right of the foreign investor to transfer capital. While the NPM provision is certainly useful from the host country's point of view to ensure that it enjoys regulatory power, such a provision is for the entire treaty and not just a particular provision. As it has been discussed above, in the present Indian IIAs, the NPM provision is quite narrow and allows deviation from investment protection only in exceptional circumstances and thus is not suitable for all kinds of monetary or non-monetary objectives. Even if this NPM provision is amended to include more permissible objectives (grounds on which a country can deviate from its investment obligations), it will be difficult to invoke the NPM provision for all purposes in case of restrictions imposed on monetary transfer. So, while the NPM provision might be invoked in cases of severe BoP crisis depending on the formulation, it cannot be invoked for other macroeconomic objectives like maintaining healthy exchange rate or for other non-monetary objectives like protecting the rights of the creditors. Thus the need is to have an exception within the MTP so as to let the host country exercise regulatory power for different policy objectives. This is also warranted by India's own policy of not having full CAC and adopting a cautious approach towards capital accounts liberalization and Indian domestic law that recognizes the requirement to impose restrictions on capital account transactions.

### *NPM*

Recent treaty practice suggests that countries are adopting comprehensive NPM provisions in their IIAs<sup>978</sup> in order to ensure that specific policy objectives are achieved without violating the IIA.<sup>979</sup> This practice indicates that countries are starting to realise the limitations of the 'police power' argument, which is often advanced as a response to a critique of textual indeterminacy in IIAs affecting host country's regulatory power.

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<sup>977</sup> For more examples of IIAs recognizing exceptions to the provisions on monetary transfer see – Gallagher (2012), 128-130.

<sup>978</sup> Subedi (2008), 185-187; Salacuse (2010), 341-342; Spears (2010), 1059-1062. Also see Muchlinski (2009), 37-45; Footer (2009), 42.

<sup>979</sup> Newcombe (2011), 356.

The textual indeterminacy of the NPM provision in Indian IIAs can be overcome if India reformulates its NPM provisions by adding 'non security' related permissible objectives such as 'economic and social development', 'public health', 'environment', 'public order and public interest', 'economic crises'. Thus, with 'economic and social development' as a permissible objective in the IIA, India will not be worried to show that its NPM for such economic and social development need falls under ESI (which will require a high threshold). These 'non security' related permissible objectives should not be self judging; though the 'security' related permissible objectives may be made self judging, but not non-justiciable and thus open for a good faith review. Making 'security' related permissible objectives non-justiciable might be misused to the detriment of investment protection.

Besides this, since the NPM provision will have permissible objectives divided into 'security' and 'non-security' related objectives, CEE as a permissible objective will not be needed because any circumstance of extreme emergency related to 'non-security' situations will be dealt under the 'non-security' related permissible objectives and any circumstance related to security situation under 'security' related permissible objectives.

The counter argument to reformulating NPM provisions aimed at including more permissible objectives is that a large number of permissible objectives may result in excessive regulatory power for India jeopardising investment protection. Such fears can be quelled by having 'necessary' or 'related to' as the nexus requirement for different permissible objectives and not 'for'. In case of having 'necessary' as the nexus requirement, the NPM provision should provide that 'necessary' will be interpreted using the LTIARA test so as to bar the tribunal from undertaking a proportionality test to find out whether a measure is 'necessary'. Such clarification assumes importance in light of the type of interpretation adopted by the *El Paso* tribunal. It is imperative that India makes it very clear that invocation of 'necessary' in the treaty is not to be confused with any element of customary international law doctrine of necessity.

Likewise, in order to make sure that NPM provisions balance investment protection with regulatory power and are not abused, imposition of NPMs should be subjected to conditions such as measures shall be applied normally, reasonably and on a non discriminatory basis as it is presently formulated in majority of NPM provisions in Indian IIAs. However, these

conditions should exist for ‘non-security’ related permissible objectives and not for security related permissible objectives.

A suitably formulated NPM provision will preserve India’s regulatory power along with investment protection.<sup>980</sup> Further, a comprehensive NPM provision in the IIA and the rights and defences under CIL can co-exist unless the IIA states anything to the contrary. In other words, the NPM provision is activated only once the country has violated one of the substantive IIA provisions. For example, there can be cases where India successfully uses the ‘police power’ argument to convince the tribunal that it has not expropriated the investment; nevertheless fails in doing the same with FET or any other provision. In such a situation, India can still rely on the NPM provision to argue that the FET violation is excused by showing that the measure falls under the NPM provision even if the adopted NPM violates any of the treaty provisions. Thus, the NPM provision operates at a different level and does not necessarily compete with the ‘police power’ argument<sup>981</sup> and can help India justify those regulatory measures that the ‘police power’ argument will fail to justify.

Another factor that will act as a check on India not abusing the broadly formulated permissible objectives in NPM provision or for that matter any other provision that safeguards its regulatory power is the fact that India needs a ‘quantum leap’ in FDI in the coming years if it wishes to grow in double digits.<sup>982</sup> FDI flows to India remained sluggish in 2010 despite FDI flows to other emerging market economies like China and Brazil showing an upward trend.<sup>983</sup> This is a major concern in India in the backdrop of expanding current account deficit.<sup>984</sup> Thus, India needs FDI to finance its current account deficit.<sup>985</sup> For these economic reasons, India will be conscious of the fact that any abuse of the NPM provision will hurt the sentiment of foreign investors and affect India’s reputation as an attractive FDI destination. India has surely moved away from the days when it espoused the creation of a

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<sup>980</sup> Also see Burke-White and von Staden (2008); and Muchlinski (2011), 352.

<sup>981</sup> In this regard also see Newcombe (2011); Spears (2010), 1063.

<sup>982</sup> “India needs Quantum Step in Investment” ‘The Financial Times’ (17 November 2010), online <http://www.ft.com/cms/s/0/d4d67e6e-f26b-11df-a2f3-00144feab49a.html#axzz1DH4gM2ZP>.

<sup>983</sup> RBI (2012).

<sup>984</sup> Id.

<sup>985</sup> “India Attractive FDI Destination Despite Some Slowdown: Montek”, Deccan Herald (9 February 2011) online Deccan Herald <http://www.deccanherald.com/content/133008/india-attractive-fdi-destination-despite.html> - where the Deputy Chairman of the Planning Commission of India (the top most body in policy formulation) emphasized on India being an important FDI destination – showing the sensitivity attached to the ‘reputation’ factor.



new international economic order in the sixties and seventies to embracing foreign investment as an integral and not peripheral in its quest for economic development.

At this stage, it is also important to point out that India also needs to review the MFN provision in its IIAs. The *White Industries* case in context of India and other cases and academic literature on international investment law demonstrate that a broadly worded MFN provision can be used by foreign investors to borrow beneficial provisions from other IIAs. Thus, it is imperative for India to review the MFN provision so that it cannot be used to sidestep the renegotiated provisions of an IIA.

India's IIA programme is one of the biggest IIA programmes amongst developing countries. Despite this, no major study has been done to understand the Indian IIA programme in light of the growing global debate on IIAs and how they affect India's regulatory power. This thesis has aimed to fill this gap. It has endeavoured to put the Indian IIAs at centre-stage by critically analyzing them in light of the growing pros and cons of investment treaty arbitration. It has provided significant inputs towards drafting of new IIAs and re-drafting of existing IIAs aimed at balancing investment protection with India's regulatory power so that, as Lauge Poulsen says, India's sovereign right to regulate is not compromised by chance.<sup>986</sup> It is expected that this thesis will spur further research and discussion on Indian IIAs amongst Indian policy makers, academicians, researchers and the civil society.

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<sup>986</sup> Poulsen (2011).

# ANNEXURE I – LIST OF COUNTRIES WITH WHOM INDIA HAS AN IIA<sup>987</sup>

<b>S. No.</b>	<b>Country</b>	<b>Date of Agreement</b>	<b>Date of Enforcement</b>
1	The United Kingdom	14 March 1994	6 January 1995
2	Russian Federation	23 December 1994	5 August 1996
3	Germany	10 July 1995	13 July 1998
4	Denmark	6 September 1995	28 August 1996
5	Turkmenistan	20 September 1995	27 February 2006
6	The Netherlands	6 November 1995	1 December 1996
7	Italy	23 November 1995	26 March 1998
8	Tajikistan	13 December 1995	23 November 2003
9	Israel	29 January 1996	18 February 1997
10	Poland	7 October 1996	31 December 1997
11	Czech Republic Czech Republic(Protocol)	11 October 1996	6 February 1998
12	Kazakhstan	9 December 1996	26 July 2001
13	Sri Lanka	22 January 1997	13 February 1998
14	Vietnam	8 March 1997	1 December 1999
15	Oman	2 April 1997	13 October 2000
16	Switzerland	4 April 1997	16 February 2000
17	Egypt	9 April 1997	22 November 2000
18	Kyrgyz Republic	16 may 1997	12 May 2000
19	France	2 September 1997	17 May 2000
20	Spain	30 September 1997	16 October 1998

<sup>987</sup> This list only includes IIAs that India has signed and enforced and which have been studied in the thesis. It does not include those IIAs that India has signed but not enforced.

21	Belgium	31 October 1997	8 January 2001
22	Romania	17 November 1997	9 December 1999
	Romania(Protocol)	16 February 2009	21 October 2009
23	Mauritius	4 September 1998	20 June 2000
24	Turkey	17 September 1998	18 October 2007
25	Bulgaria	26 October 1998	23 September 1999
	Bulgaria(Protocol)	12 September 2007	12 May 2008
26	Morocco	13 February 1999	22 February 2001
27	Indonesia	10 February 1999	22 January 2004
28	Australia	26 February 1999	4 May 2000
29	Qatar	7 April 1999	15 December 1999
30	Uzbekistan	18 May 1999	28 July 2000
31	Argentina	20 August 1999	12 August 2002
32	Austria	8 November 1999	1 March 2001
33	Philippines	28 January 2000	29 January 2001
34	Portugal	28 June 2000	19 July 2002
35	Sweden	4 July 2000	1 April 2001
36	Thailand	10 July 2000	13 July 2001
37	Lao PDR	9 November 2000	5 January 2003
38	Mongolia	3 January 2001	29 April 2002
39	Croatia	4 may 2001	19 January 2002
40	Kuwait	27 November 2001	28 June 2003
41	Ukraine	1 December 2001	12 August 2003
42	Cyprus	9 April 2002	12 January 2004
43	Yemen	30 October 2002	10 February 2004
44	Finland	7 November 2002	9 April 2003
45	Belarus	27 November 2002	23 November 2003
46	Serbia	31 January 2003	24 February 2009
47	Armenia	23 May 2003	30 May 2006
48	Sudan	22 October 2003	18 October 2010
49	Hungary	3 November 2003	2 January 2006
50	Bahrain	13 January 2004	5 December 2007
51	Saudi Arabia	25 January 2006	20 May 2008
52	Bosnia and Herzegovina	12 September 2006	14 February 2008
53	Slovak Republic	25 September 2006	16 June 2007
54	China	21 November 2006	1 August 2007
55	Jordan	1 December 2006	22 January 2009
56	Trinidad and Tobago	12 March 2007	7 September 2007
57	Greece	26 April 2007	12 April 2008
58	Mexico	21 May 2007	23 February 2008
59	Libya	26 May 2007	25 March 2009
60	Iceland	29 June 2007	16 December 2008
61	Macedonia	17 March 2008	17 October 2008
62	Brunei	22 May 2008	15 February 2009
63	Syria	18 June 2008	22 January 2009
64	Myanmar	24 June 2008	8 February 2009

65	Senegal	3 July 2008	17 October 2009
66	Mozambique	19 February 2009	23 September 2009
67	Latvia	18 February 2010	27 November 2010
68	Bangladesh	9 February 2009	7 July 2011
69	Lithuania	31 March 2011	1 December 2011
70	Singapore		1 August 2005
71	Korea	7 August 2009	1 January 2010
72	Malaysia	18 February 2011	1 July 2011
73	Japan	16 February 2011	1 August 2011

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